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Predatory Public Finance and the Origins of the War on Drugs *1984–1989*

BRUCE L. BENSON AND
DAVID W. RASMUSSEN

The Harrison Act of 1914 is often cited as the law that made consumption of narcotics illegal. In reality, the Harrison Act established very modest "sin taxes" on the sale of narcotics such as opiates. What became illegal as a result of the act was the possession or sale of untaxed narcotics. Policy against marijuana began in a similar fashion with passage of the Marijuana Tax Act in 1937.[1] Sin taxes such as these inevitably lead to crime, however, as individuals attempt to avoid the tax through black markets, smuggling, and the violent forms of competition and contract enforcement that accompany such activities. An excise tax may reduce the level of the sin being taxed, but it simultaneously induces new kinds of sin that are often much more costly for society. This occurred with narcotics and marijuana. However, rather than recognize the source of the crime and eliminate the sin taxes, full-blown criminalization of possession or sale of narcotics and marijuana evolved as bureaucrats who were given the authority

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1. The Marijuana Tax Act was nominally a revenue-producing act that imposed taxes on physicians who prescribed marijuana, pharmacists who dispensed it, and others who might deal in the drug. The nonmedical possession and sale of the drug were made illegal, however, and all those in the production and distribution chain for medical purposes were required to keep detailed records and pay annual fees. These onerous record-keeping requirements, taxes, and fees effectively ended the legal use of the drug for medical purposes as well.

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to police these markets and collect the taxes propagated the belief that it was the "sin" of drug consumption that produced the crime, rather than the incentives to avoid the taxes imposed on the sin. The purpose of the following is to show that bureaucratic self-interest and predatory public finance in the form of explicit or implicit sin taxes have been and continue to be the primary determinants of public policy in the area of illicit drug control.

When sin-tax-induced crime becomes a serious problem, the government entity imposing the tax has at least these two options: to crack down on the resulting crime or to repeal the sin tax. Consider Quebec's recent experiences with taxes on cigarettes, for instance. A 9 August 1993 article in *Maclean's*, a leading Canadian newsmagazine, notes that "Tax levels in excess of 60 per cent on cigarettes have convinced many smokers that they are justified in breaking the law." Roughly half the cigarettes in Quebec and some other Canadian provinces were being bought in illegal black markets in order to avoid excise taxes; indeed, one in nine cigarettes consumed in the entire country was illegally purchased. As one buyer of black market cigarettes explained, "Stupid laws are meant to be broken." As noted earlier, however, tax evasion is not the only crime arising from sin taxes. Canada's illegal cigarettes were smuggled across the border. Canada exported roughly 7.6 billion cigarettes to the United States in 1992, for instance, and police estimate that 80 percent were smuggled back into Canada. Cigarette smuggling was so lucrative that organized crime got involved. Rival smuggling gangs exchanged gunfire as they competed for shares of the illegal market. They stole large boats, armed them with mounted guns, and painted them black for nighttime smuggling. Thus, an inevitable cost of high excise taxes was that crime rose, so demands for already-pressed policing, courts, prisons, and other law enforcement services increased. Canadian police were forced to become involved in the same kinds of interdiction efforts against cigarettes the United States is attempting today with illegal drugs. The results were similar: the flow of illegal cigarettes into Canada was unabated. Further, a crackdown on the sin-tax-induced crime means that either taxes have to be raised to support a larger criminal justice system or some of the society's precious criminal justice resources have to be shifted away from efforts to deter burglars, robbers, rapists, and other criminals who threaten lives and property, in order to control black markets, smuggling, and the violence that arises with these activities. Quebec citizens apparently recognized this, and in 1994 the Quebec government announced a massive reduction in cigarette tax in an effort to end uncontrollable smuggling.

The Wages of Sin Taxes

Citizens of the United States did not see the consequences of sin taxes on narcotics and marijuana that Quebec citizens recognized regarding the taxes on cigarettes. Thus, the United States took a different route. Crime control became the focus of public policy. Nonetheless, sin taxes remain extremely

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relevant to this day in a different form, as asset seizure laws have been revised to allow law enforcement bureaucrats to "tax" those who participate in illicit drug markets. Indeed, this helps explain why so many state and local components of the criminal justice system responded to the federal call for the latest offensive in the "war on drugs" after 1984.

The most recent renewal of the war on drugs in the United States was declared by President Reagan in October 1982 (Wisotsky 1991). Such an offensive in United States had to be waged by state and local "troops," however, and state and local law enforcement agencies generally did not increase their relative efforts against drugs in a dramatic fashion until 1984, when a substantial reallocation of state and local criminal justice system resources toward drug enforcement began. In fact, although drug arrests relative to arrests for reported crimes against persons and property (Index I offenses of murder, manslaughter, sexual assault, assault, robbery, burglary, larceny, and auto theft) remained relatively constant at one to four from 1970 to 1984, the *relative* effort against drugs increased by roughly 45 percent over the next five years. By 1989, criminal justice resources were being allocated to make only about 2.2 Index I arrests for each drug arrest.

There are a number of possible explanations for the upsurge in drug enforcement. Perhaps local elected officials, representing median-voter preferences across the nation, almost simultaneously demanded that their police departments escalate the war on drugs. There are strong indications that this explanation does not hold, however (Rasmussen and Benson 1994, 122–27). For example, in 1985, public opinion surveys suggested that drug use was not considered an especially significant problem. Indeed, illicit drug policy appears to be a case in which policy changes led public opinion, at least during the escalation of the drug war over the 1984–89 period. Another explanation for the trends in the reallocation of local police resources during this period is that powerful interest groups demanded the war. As Chambliss and Seidman (1971) concluded, "every detailed study of the emergence of legal norms has consistently shown the immense importance of interest-group activity, not the public interest, as the critical variable" (73). Similarly, Rhodes (1977) pointed out that "as far as crime policy and legislation are concerned, public opinion and attitudes are generally irrelevant. The same is not true, however, of specifically interested criminal justice publics" (13). More recent research reaches similar conclusions,[2] and also makes it clear that one of the most important

2. Bureaucrats often try to influence the demand side of the political process (Berk, Brackman, and Lesser 1977; Congleton, 1980; Breton and Wintrobe, 1982; Benson 1983, 1990; Mbaku, 1991). They have incentives to "educate" the sponsor regarding interest-group demands that complement their own and to "propagate" their own agenda. Furthermore, they may have a relative advantage in the lobbying process because they have ready access to the sponsor with whom they are often informally networked (Breton and Wintrobe 1982, 41–42), and they are naturally called upon, due to their expertise. This is clearly the case with law enforcement bureaucracies (Glaser 1978, 22). Additional discussion of the role of bureaucrats as demanders of legislative action appears in the next two sections of this paper.

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"specifically interested criminal justice publics" consists of law enforcement bureaucrats (e.g., Berk, Brackman, and Lesser 1977; Benson 1990, 105–26; Rasmussen and Benson 1994, 119–73). In order to establish the argument that police bureaucracies have considerable power in the game of interest-group politics, at least as it pertains to drug legislation, in the next section we will briefly examine law enforcement influences on the historical emergence of illicit drug legislation and subsequent criminalization. We will do so in the context of Breton and Wintrobe's model of bureaucratic efforts to establish policy. The significant role that entrepreneurial bureaucrats have played in the development and evolution of drug policy is emphasized as a prelude to the "Police Interests" section, in which we examine federal legislation during the 1980s from the same perspective.

The "Police Interests" section provides an explanation for state and local police involvement in the 1984–89 drug war. Specifically, state and local policing officials faced what presumably was an exogenous change in bureaucratic incentives (although at least some of these police officials were important sources of the demand for the change) that induced an increase in drug enforcement efforts. In particular, one section of the Comprehensive Crime Act of 1984 established a system whereby any local police bureau that cooperated with federal drug enforcement authorities in a drug investigation would share in the money or property confiscated as part of that investigation. As a result, police in many states whose own laws or constitutions limited confiscation possibilities began to circumvent state laws by having federal authorities "adopt" their seizures.[3] Thus, under the 1984 federal statute, a substantial percentage of these seized properties went back to the agency that seized them, even if the state's laws mandated that confiscations go someplace other than to law enforcement. This asset seizure law not only established a way to tax the sin of involvement in drug markets, but it required that the resulting revenue go to the tax collector—the law enforcement agency—thus creating relatively strong incentives to collect the tax. Demanded by federal, state, and local law enforcement bureaucrats, this legislation largely reflects the bureaucratic competition and cooperation modeled by Breton and Wintrobe (1982).

Perhaps local police bureaucracies advocated such legislation and joined in the drug war because they perceived it to be in the "public interest." Considerable evidence suggests that the opportunity costs of resources allocated to the war on drugs have been very high,[4] however, and a good

3. Many states mandated that confiscated assets be turned over to a general government authority, whereas others required that some or all seized assets be used for specific purposes, such as drug treatment or education. Various states also limited the kinds of assets that could be seized. For instance, in 1984, only seven states allowed seizure of real estate used for illegal drug activities. The federal statute had no such limitation.

4. See Reuter (1991), Benson and Rasmussen (1991, 1992), Benson and others (1992), Rasmussen, Benson, and Sollars (1993), Sollars, Benson, and Rasmussen (1994), Rasmussen and Benson (1994), and Zimring and Hawkins (1992).

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deal of evidence also indicates that many law enforcement bureaucracies created misinformation in order to exaggerate the potential benefits of a drug war (Michaels 1987, 311–24). This is relevant because if confiscations can be used at the discretion of local police bureaucrats to significantly enhance their own well-being, then this federal statute may explain a substantial portion of the changes in the allocation of local police resources after 1984. Local interbureau competition for resources may lead government decision makers (bureau sponsors) to treat confiscations as a substitute for ordinary appropriations. Therefore, an important component of the "Police Interests" section is the summary of a case study by Benson, Rasmussen, and Sollars (1995) of the budgetary impact of local police confiscations from the drug war. The findings are consistent with the hypothesis that confiscations legislation creates significant incentives to change the allocation of police resources.

Not all states were equal participants in the 1984–89 war on drugs. In a few states drug arrests accounted for a smaller portion of all arrests in 1989 than in 1984. These are the exceptions, however. The largest states, such as California, Florida, Michigan, Illinois, and Pennsylvania, increased drug enforcement to an extent that the U.S. drug arrest/total arrest ratio rose 67 percent between 1984 and 1989—from 5.8 percent to 9.7 percent. As table 1 shows, there is significant variation in drug enforcement activity across states as well as through time. If the "sin-tax/bureaucratic-self-interest" story actually provides a strong explanation of drug enforcement policy, it should help explain cross-sectional variation in enforcement policy as well as time series variation. This question has been explored in a cross-sectional analysis of cities' drug enforcement policies (Rasmussen, Benson, and Mast 1994). Since federally "adopted" seizures are only partially turned back to the local police (the federal authorities extract a 20 percent handling charge), police in states whose own laws allow them to retain seized assets are able to obtain even greater benefits from seizures than police who must involve federal authorities in the process. Thus, a self-interest view of police bureaucrats suggests that in states whose laws allow the police to retain seizures, police will focus relatively greater efforts against drugs than police do in states whose laws take such seizures away from the police. This expectation is supported by the empirical results in Rasmussen, Benson, and Mast (1994). These findings and their implications are explored in the "Differences in Drug Enforcement" section.

The escalation of the U.S. war on drugs ended in 1989. Indeed, after 1989, a substantial reduction in drug enforcement effort occurred. The concluding section offers several potential explanations for this down-cycle in drug policy, all of which are consistent with the sin-tax/bureaucratic-self-interest arguments that explain the 1984–89 escalation of drug enforcement.

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Table 1: Drug Arrests per 100,000 Population, by State, 1984 and 1989

STATE	RANK	1989	1984	%CHG	STATE	RANK	1989	1984	% CHG
Alabama	21	392	190	106.3	Montana	27	332	130	155.4
Alaska	44	162	120	35.0	Nebraska	32	283	150	88.7
Arizona	11	519	380	36.6	Nevada	42	170	110	54.5
Arkansas	30	311	230	35.2	New Hampshire	35	265	138	92.0
California	1	1,060	590	79.7	New Jersey	2	895	460	94.6
Colorado	33	279	230	21.3	New Mexico	13	454	300	51.3
Connecticut	8	647	270	139.6	New York	3	799	510	56.7
Delaware	28	329	230	43.0	North Carolina	20	411	261	57.5
Florida	6	675	360	87.5	North Dakota	49	107	160	-33.1
Georgia	7	661	344	92.1	Ohio	17	426	190	124.2
Hawaii	25	355	420	-15.5	Oklahoma	29	327	270	21.1
Idaho	39	221	140	57.9	Oregon	15	438	240	82.5
Illinois	14	446	120	271.7	Pennsylvania	34	274	130	110.8
Indiana	41	189	130	45.4	Rhode Island	19	422	380	11.1
Iowa	46	119	90	32.2	South Carolina	12	470	300	56.7
Kansas	37	233	140	66.4	South Dakota	47	118	190	-37.9
Kentucky	9	528	300	76.0	Tennessee	36	263	160	64.4
Louisiana	10	526	270	94.8	Texas	16	433	360	20.3
Maine	38	229	130	76.1	Utah	31	291	320	-9.1
Maryland	4	776	420	84.8	Vermont	48	109	n.a.	n.a.
Mass.	5	689	310	122.3	Virginia	26	341	200	70.5
Michigan	23	374	170	120.0	Washington	24	369	170	117.1
Minnesota	45	161	130	23.8	West Virginia	50	88	100	-12.0
Mississippi	22	375	190	97.4	Wisconsin	40	207	200	3.5
Missouri	18	422	240	75.8	Wyoming	43	169	180	-6.1
					United States		538	312	72.4

Source: U.S. Department of Justice, Bureau of Justice Statistics (1984/1989).

Police Bureaucrats, Interest Group Politics, and Drug Policy

There are many models of bureaucratic behavior based on self-interest assumptions. Tullock (1965) saw bureaucratic behavior driven by a desire for security. Chant and Acheson (1972) contended that a desire for prestige drove bureaucratic behavior. Niskanen (1968, 1971) assumed that a bureau manager could be characterized as a budget maximizer. Migué and Belanger (1974) explained that budget maximization unduly limits the range of utility-maximizing efforts, however, and proposed that the bureaucrat seeks

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discretion reflected by a budget with excess revenues over actual costs (an argument Niskanen accepted [1975]).[5]

Public officials are presumably characterized by the same basic utility-maximizing behavior that motivates people operating in private markets. The institutional framework of public officials may differ from that of private-sector employees, but their fundamental objectives do not. Employment security is a desirable job attribute in the private sector, for instance. The U.S. Department of Health, Education, and Welfare Task Force (1973) found that job security, along with interesting work and opportunity to develop special skills, were considered to be the most important features of job quality. Not surprisingly, civil service bureaucrats are also very concerned about job security (Johnson and Libecap 1989). The same point can also be applied to elected officials, whose desire to be reelected is consistent with this broadly held desire for secure employment. Surveys of private-sector employees identify other sources of worker satisfaction that may be equally applicable to elected and appointed public officials and civil-servant bureaucrats: good pay; *discretionary* authority, information, and opportunity to get the job done; and seeing the results of one's work. Discretion to control the intensity and pace of work is also an important job characteristic, and some research suggests that part of the wage premiums paid to workers in very large manufacturing plants is explained by the absence of this job attribute (Stafford and Duncan 1980). Thus, discretion itself may be a major source of satisfaction for bureaucrats and public officials (Parker 1992).

Job characteristics people value in a private setting are not likely to lose their allure just because someone is engaged in public-sector employment. In this light, Breton and Wintrobe (1982) noted: "In addition to size, budgets, discretion, prestige, and self-preservation, it has been suggested that security, the avoidance of risk or responsibility, secrecy, complexity, career promotion, leisure, internal patronage, and a bureaucrat's personal conception of the common...good are objectives of bureaucrats, either one at a time or in groups" (27). They suggested that all of these factors may enter a bureaucrat's utility function and that no general theory of bureaucratic behavior can be built by specifying a particular objective. Thus, they assumed general utility maximization and focused on the institutional setting (e.g., the intensity of interbureaucratic competition for budget shares and intrabureaucratic competition for promotions and positions in networks, the existence of barriers to mobility, the ability of superiors and sponsors to monitor performance, and so on) as the determinant of which particular objective will appear to dominate in a particular bureau. Breton and Wintrobe characterized the bureaucratic institutional process as one domi-

5. A large literature has developed following in this Niskanen/Migué-Belanger framework: see Toma and Toma (1980), Gonzalez and Mehay (1985), Benson and Greenhut (1986), Wyckoff (1988, 1990a, 1990b), and Kress (1989).

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nated by "entrepreneurial competition," wherein individual bureaucrats pursue their subjective goals by selectively seeking and implementing policy innovations.[6] This characterization fits the role played by law enforcement bureaucrats in the evolution of U.S. drug criminalization policy.

Actually, a number of self-interest political motivations for demanding drug legislation have been identified for both bureaucratic and nonbureaucratic interest groups. Some studies have noted the incentives of professional organizations such as the American Pharmaceutical Association to create legal limits on the distribution of drugs (there was significant competition between pharmacists and physicians for the legal right to dispense drugs, for example),[7] whereas others have focused on the strong racial impacts of illicit drug laws and the desire by some groups to control racial minorities through the enforcement of such laws.[8] More important from the perspective stressed here, however, others have emphasized that law enforcement bureaucrats were a major source of demand for criminalization of narcotics after the Harrison Act was passed and for passage of the Marijuana Tax Act and subsequent criminalization of this illicit drug.[9]

Breton and Wintrobe (1982, 146–54) explained that one bureaucratic strategy to compete for resources is to "generate" demand for a bureau's own services through direct lobbying, policy manipulation, and the selective release of information to other interest groups and the media. This occurs

6. This competition is multidimensional. It includes general competition for resources as well as competition for positions and promotions in the formal bureaucratic structure and membership in the informal networks that bureaucrats develop to facilitate nonmarket exchanges of benefits, information, and support among network members. Competitive strategies employed include "(i) alterations in the flows of information or commands as these move through or across the hierarchical levels of the organization; (ii) variations in the quality or quantity of information leaked to the media, to other bureaus in the organization, to special interest groups, and/or to opposition parties and rival suppliers; and (iii) changes in the speed of implementation of policies as these are put into effect" (Breton and Wintrobe 1982, 37–38). These strategies and selective behavior in general are possible because of the way bureaucratic organizations and hierarchies work, including the fact that monitoring by sponsors is costly and the measurement of bureaucratic performance is generally difficult or impossible. Indeed, the use of such strategies can increase monitoring costs and make measurement of performance even more difficult.

7. See Musto (1987, 13–14, 21–22), Thornton (1991, 56–60), and Klein (1983, 31–55).

8. Bonnie and Whitebread (1974), Helmer (1975), Musto (1987), and Nadelmann (1993).

9. See Himmelstein (1983), Becker (1963), Bonnie and Whitebread (1974), King (1957), Dickson (1968), Oteri and Silvergate (1967), Lindesmith (1965), Hill (1971), and Reinarman (1983). In fact, as Thornton (1991, 62, 66) and Morgan (1983, 3) stressed, all of the various self-interests mentioned (bureaucrats, professionals from the American Medical Association and American Pharmaceutical Association, and groups attempting to suppress certain races or classes) interacted with still more groups (temperance groups, religious groups, and so on) to produce policies against drug use. Interest groups and bureaucratic entrepreneurs continue to dominate modern drug policy as well. These groups include "civil rights, welfare rights, bureaucratic and professional interests, health, law and order, etc." (Morgan 1983, 3). For instance, the pharmaceutical industry had a significant impact on the Comprehensive Drug Abuse Prevention and Control Act of 1970: "In this case as in most others, the state's policy makers were buffeted by law enforcement interests and professional interests" (Reinarman 1983, 19).

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because bureaucrats must compete with other bureaucracies for the support and attention of sponsors (and individual bureaucrats must compete with other bureaucrats for benefits within a bureau), and because the control of resources is necessary before bureaucrats can achieve most of their subjective goals.[10] Indeed, Lindesmith (1965) contended that the nation's program for handling the "drug problem" is one "which, to all intents and purposes, was established by the decisions of administrative officials of the Treasury Department" (3). Why would the Treasury Department care about drug criminalization? Because the Harrison Act established federal taxes on narcotics, and the Treasury Department's Federal Bureau of Narcotics was responsible for its enforcement. For several years after its passage in 1914, the Harrison Act remained a rather unimportant source of taxes and regulatory measures (Reinarman 1983, 21). Indeed, its most important consequence may have been that a bureaucracy grew up to enforce the act. Given its regulatory powers, the Federal Bureau of Narcotics chose to instigate criminalization of opiate users with a series of raids on morphine treatment clinics in 1919.[11] King (1957) maintained that "the Narcotics Division launched a reign of terror. Doctors were bullied and threatened, and those who were adamant [about treating addicts] went to prison" (122). Efforts by bureaucrats in the Narcotics Bureau led to a series of court decisions that reinterpreted the Harrison Act and became the pretext for criminalization of drug use (Reinarman 1983, 21). Furthermore, because of pressure from people in the same bureau, the Marijuana Tax Act was passed in 1937.[12] Some writers have stressed moral entrepreneurship by Narcotics Bureau officials (e.g., Becker [1963]), but others have focused on bureaucratic fiscal self-promotion (e.g., Dickson [1968]). The bureau was in need of a new raison d'être for continued funding in 1937, as it faced stiff competition from the FBI for the attention of the public and congress (King 1978), both of whom wanted crime control to be in the domain of the FBI rather than the Treasury Department's Narcotics Bureau.

Breton and Wintrobe (1982, 39) emphasized that bureaucratic release of both true and false information, or "selective distortion," can play significant roles in bureaucratic policy advocacy.[13] This has clearly been the case in the evolution of drug policy. For example, the bureaucratic campaigns leading to the 1937 marijuana legislation "included remarkable distortions

10. See Stutmann and Esposito (1992) for a very revealing examination of the actual activities of a DEA agent, and note the tremendous amount of time and effort that this agent spent in competing for resources. Also note the significant role that politics played in determining the allocation of drug enforcement resources. This entire book could be easily set in the context of the Breton-Wintrobe model of bureaucratic entrepreneurship.

11. King (1957); Lindesmith (1965); Klein (1983, 32).

12. Becker (1963); Dickson (1968); Oteri and Silvergate (1967); Lindesmith (1965); Hill (1971); Bonnie and Whitebread (1974).

13. This is suggested by the second strategy listed in note 6, and arises in part because of the high cost of monitoring bureaucrats.

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of the evidence of harm caused by marijuana, ignoring the findings of empirical inquiries."[14] The "reefer madness" scare traces to the misinformation propagated by the Bureau of Narcotics. Marijuana was alleged to cause insanity, incite its users to rape, and produce a delirious rage in users, making them irresponsible and prone to commit violent crimes. Distortions did not stop there. For instance, the bill was represented as largely symbolic in that it would require no additional enforcement expenditures (Galliher and Walker 1977).

The evolution of drug policy since initial legislation has also been, at least in part, shaped by bureaucratic competition, both between law enforcement and drug treatment bureaucrats over "ownership of the problem"—that is, over shares of federal, state, and local budgets (Gusfield 1980; Morgan 1983)—and between law enforcement bureaucracies themselves (e.g., between the DEA and the FBI [King 1978] at the federal level, as well as among various local, state, and federal bureaucracies). This evolution reflects another aspect of the bureaucratic process emphasized by Breton and Wintrobe (1982). As the perceived responsibility for some social ill (e.g., crime in this case, and inflation in Breton and Wintrobe's) shifts from outside forces to the government, and hence to the bureaucracy, bureaucrats seek to shift the blame elsewhere (Breton and Wintrobe 1982, 149). Blaming crime on people crazed by drugs provides an opportunity to shift blame.

A good deal of false or misleading information emanating from police bureaucrats about the relationship between drugs and crime has clearly characterized the evolution of drug policy.[15] In fact, a primary source of the "information" (much of which was inaccurate and/or unsubstantiated [Michaels 1987, 311–24]) used to justify the 1984–89 war on drugs was the police bureaucracies. Primarily as a result of information promulgated by police (Barnett 1984, 53), it has become widely believed that drug crime is the root cause of much of society's problems (e.g., see the Office of National Drug Control Strategy [1990, 2]). In particular, drug use is claimed to be a leading cause of nondrug crime because, it is contended, property crime is a major source of income for drug users. This claim has served to justify political demands for the criminal justice system to do something about the drug/crime problem, demands that emanate largely from the police lobbies (e.g., see Berk, Brackman, and Lesser [1977]; Barnett [1984]; Benson [1990]; and Rasmussen and Benson [1994]), and in turn, to justify an emphasis on control of illicit drug traffic as a means of general crime prevention.

State and federal legislators have passed increasingly strict sentencing laws for drug offenders, police have shifted resources to make more drug

14. Richards (1982, 164). For details see Kaplan (1970, 88–136), Lindesmith (1965, 25–34), Himmelstein (1983, 60–62), and Bennett and DiLorenzo (1992, 237–39).

15. Lindesmith (1965); Kaplan (1970, 1983); Richards (1982); Michaels (1987); Bennett and DiLorenzo (1992); Rasmussen and Benson (1994).

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arrests, and judges have sentenced increasing numbers of drug offenders to prison. Such a reallocation of resources would appear to be justified if drugs truly are the root cause of most other crime, but these causal relationships do not actually hold. In particular, increased drug enforcement efforts tend to cause increases in crime, as other types of crime are less effectively deterred.[16] Thus, the opportunity costs of the war on drugs appear to be quite high. This should not be surprising, of course, given the history of failure of drug and alcohol prohibition policies (Thornton 1991; Nadelmann 1993). The question, "why has this reallocation occurred?" would appear to be even more pressing, given the circumstances.

Breton and Wintrobe (1982, 150–51) offer two reasons bureaucrats advocate a policy of direct control of a source of blame (e.g., alcohol prohibition, criminalization and prohibition of various drugs after 1914 and 1937, increased emphasis on drug control in the mid-1960s, and then again in the mid-1980s), even though such policies have a history of failure. First, there is always opposition to such a policy, so when it fails the opposition can be blamed for not allocating enough resources to combat the problem. And second, since the outcome of the policy depends jointly on the inputs of several different groups and bureaus, and the set of possible control methods is very large, when the subset selected fails, the bureaucrats can argue one or both of the following: (1) although they advocated a control policy, they favored a different subset of control tools (e.g., more severe punishment of drug offenders, greater spending on interdiction efforts), so they are not responsible for the failure; (2) the other groups who had to contribute to make the effort successful (e.g., witnesses, judges, legislators who approve prison budgets, other law enforcement agencies) did not do their share. Indeed, a policy can fail completely while at the same time entrepreneurial bureaucrats expand their reputations and end up being substantially better off.[17]

The ongoing competition for a share of the total budget is always an important factor. After all, few of the subjective goals of bureaucrats can be achieved without a budget. Therefore, each bureau must demonstrate that it is doing a good job in serving its constituencies. The function of police in the minds of most citizens is to "fight crime," of course, but how can interest groups, voters, taxpayers, and elected representatives tell if police are doing a good job? The number of crimes prevented cannot be quantified. Therefore, police need statistical indicators of their "productivity" to use in their lobbying efforts for expanded budgets (Sherman 1983, 156). The

16. See Benson and others (1992), Sollars, Benson, and Rasmussen (1994), and Benson and Rasmussen (1991). Rasmussen, Benson, and Sollars (1993) provide evidence that violent crimes may also be caused by drug enforcement; see also Reuter (1991) in this regard.

17. Note with Breton and Wintrobe (1982) that "one need not assume Machiavellian behavior, deceit, or dishonesty on the part of bureaucrats, because in all likelihood the pursuit of their own interest will be, as it is for everyone else, veiled in a self-perception of dedication and altruism" (152).

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number of arrests is a natural measure of "effectiveness," and this is a primary "statistic" police focus on in the budget negotiation process. Others include response times following emergency calls and, increasingly, asset seizures. Indeed, drug prohibition provides a source of arrests that does not require waiting for some victim to report a crime, *and* it provides a new statistical indicator of effectiveness: the value of drug seizures (and of nondrug property seizures, as will be discussed).[18]

Under prohibition, police incentives may be even more "perverted" than suggested so far: there are actually incentives to allocate resources in order to avoid deterring Index I crime. After all, although arrest statistics may be primary indicators of police performance used in the budget bargaining process, they are not the only important statistic used in such bargaining. As Milakovich and Weis (1975) noted, police have a "vested interest" in keeping crime rates relatively high: if crime rates drop too much, then support for more police and larger budgets declines, and "like all bureaucracies, criminal justice agencies can hardly be expected to implement policies that would diminish their importance" (10). The literature on the economics of crime indicates that higher Index I crime rates clearly are correlated with more police resources in "demand for policing" equations, supporting the assumption that political demands for police services rise if reported crime rates are high. But if police do respond to the incentives outlined here, additional funding need not lead to any decrease in reported crime rates. Police can focus resources on drug control, which can lead to both increased arrests and drug seizures as indicators of effectiveness while, simultaneously, increasing Index I crime rates suggest a greater need for police services. But these incentives have been in place since drugs were initially criminalized. Something else must have changed in 1984 to produce the significant reallocation of policing resources documented above. Indeed, something else did change, at least for the police in many states. A bureaucratically motivated policy innovation appears to have created explicit incentives for shifting resources toward drug enforcement. This innovation allowed police agencies to benefit directly through the collection of a sin tax: the police were given the opportunity to collect a tax in the form of confiscations of money and property used in or purchased with profits from the drug trade *and* to keep the proceeds from this tax.

18. Once a prohibition policy is in place, police have incentives to make large drug seizures in order to demonstrate their effectiveness in controlling drug-market activity. In fact, as one of their "selective distortions," police have incentives to exaggerate the magnitude of the seizures they make. Thus, drug seizures are always reported in terms of their "estimated street value" no matter at what stage of the distribution and processing chain the seizure is made. Claiming that pure cocaine has a value equal to its retail value after it has been processed and distributed as crack is like claiming that the two or three cents worth of wheat that goes into a loaf of bread is worth the dollar consumers pay for that loaf of bread: it ignores the other inputs that must be added to turn the wheat into a marketable loaf of bread, such as transportation costs, processing costs, packaging, distribution costs, and advertising.

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Police Interests in Federal Confiscations as a Sin Tax

Government seizure of property used in criminal activity is actually a long-standing practice. It was one stimulus for the king's involvement in law enforcement as early as the ninth and tenth centuries (Benson 1990), for instance, and was first used in the United States to combat smugglers who avoided import duties in the early nineteenth century. Now it is being used to combat the supply of illicit drugs. Federal officials confiscated over $100 million in 1983, and the Comprehensive Crime Act of 1984 broadened support for the practice as the law required the Justice Department to share the proceeds with state and local agencies participating in the investigations. Perhaps as a result of the cooperation this produced, confiscations roughly doubled every year beginning in 1985, reaching a total of almost $3 billion in cash and saleable assets, and $2 billion in unsold assets by the end of 1992 (Levy 1996, 151).

The 1984 federal asset forfeiture law was a bureaucratically demanded innovation that allowed for an expanded interbureaucratic network of cooperation. As Breton and Wintrobe (1982, 128) explained, cooperation through informal networks, both within and across bureaucracies, is an alternative to competition. A reduction in the intensity of competition allows bureaucrats greater discretion in the pursuit of their subjective goals.[19] On the surface at least, this innovation apparently allowed local law enforcement agencies to generate revenues not limited by the interbureaucratic competition for resources that arises in the local budgeting process, because the statute mandated that shared assets go directly to law enforcement agencies rather than into general funds, education funds, or other depositories mandated by many state forfeiture laws. An increase in the revenues from drug-related seizures creates the potential for bureaucratic managers to expand their discretionary budget, thereby enhancing their own well-being directly *and* indirectly by rewarding supporters in the managers' networks with various "perks" (Breton and Wintrobe 1982, 137). After all, police have considerable discretion in how they allocate the resources they control, and monitoring generally does not limit their discretion in any substantial way.[20] Therefore, inasmuch as this new source of revenue has

19. The role of informal networks within and across bureaucracies is very important in the Breton-Wintrobe model (1982, 78–87, 99–106). These networks are the nonmarket institutions of exchange through which individual bureaucrats cooperate in order to obtain benefits. Thus, competition for positions in networks is also an important determinant of bureaucratic behavior (Breton and Wintrobe 1982, 99), and to the extent that this expanded network is able to generate more benefits for bureaucrats, competition to enter the network should intensify. However, competition for positions within a network actually tends to increase the potential for discretionary or selective behavior in Breton and Wintrobe's model (1982, 103).

20. Stumpf (1988, 327–32); Williams (1984, 77–105); Benson (1990, 132–46, 163–68); Rasmussen and Benson (1994, 32–37).

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increased the police's ability to control resources, it has probably increased their discretionary ability to generate perks.

Forfeiture has an obvious potential deterrent value in that it raises the costs associated with drug offenses. Indeed, the justification for asset seizures is precisely the same as the justification for an explicit excise tax on sin. The activity being taxed should be reduced as a consequence of the tax, whether the tax is explicit in the form of an excise charge on the legal sale of the sinful commodity or implicit in the form of the seizure of assets arising from the illicit sale of the sinful commodity. Sin taxes are also justified as a source of revenue that can be used to help correct the problems arising from the sin. Thus, cigarette taxes are often contended to be an appropriate source of revenue to fund health care due to alleged health costs arising from smoking. Similarly, because drugs allegedly cause crime, forfeiture policies that allocate the resulting revenues to law enforcement are said to be justified in that they can be used to recoup public moneys spent on enforcement of drug-induced crime. A manual designed to help jurisdictions develop a forfeiture capability (National Criminal Justice Association 1988) emphasized this practical aspect. Pointing out that less tangible law enforcement effects (such as deterrence) should be counted as benefits, the manual emphasized that the determining factor for pursuit of a forfeiture is "the *jurisdiction's* best interest" (40; emphasis added). This interest, of course, is viewed from the perspective of law enforcement agencies, a view that might put somewhat more weight on benefits for bureaucrats and somewhat lesser weight on communitywide (and uncertain) benefit of deterrence effects. After all, as Stumpf (1988) noted, we must "look past the external political and social determinants of criminal justice procedures and policies to understand the system in operation. The process is staffed by professionals and quasi-professionals who have their own agenda...[and] largely internal imperatives may be of even greater importance in explaining their outcomes" (316; see also Blumberg [1979]; Benson [1990]; and Rasmussen and Benson [1994]). Indeed, if forfeitures are in the "public interest" because of deterrent impacts, and if police are exclusively motivated to serve the public interest, then they should willingly cooperate in forfeiture efforts no matter what government agency's budget is enhanced by these seizures. The 1984 federal confiscations legislation directed that all shared seizures go to law enforcement, however, because of lobbying efforts by law enforcement bureaucracies, and subsequent efforts to overturn this aspect of the legislation have been vehemently opposed by these same bureaucracies.

The 1984 federal confiscations legislation followed a period of active advocacy by federal, state, and local law enforcement officials, who emphasized that it would foster cooperation between their agencies and increase the overall effort devoted to and the effectiveness of drug control; that is, law enforcement bureaus maintained that they needed to be paid to cooperate, whether the cooperation was in the public interest or not. For instance, in hearings on the Comprehensive Drug Penalty Act held before

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the Subcommittee on Crime of the Committee on the Judiciary of the U.S. House of Representatives, held 23 June and 14 October 1983, much of the testimony focused exclusively on the confiscations and forfeitures issue (U.S. House 1985). Among the organizations and bureaucracies presenting testimony in support of the forfeitures-sharing arrangement were the U.S. Customs Service, various police departments and sheriffs, the U.S. attorney's office from the Southern District of Florida, and the U.S. Drug Enforcement Administration. There was no representation of local government oversight authorities (mayors, city councils, county commissions) either supporting or objecting to such legislation. Furthermore, when the innovation was first introduced it appears that most non-law-enforcement bureaucrats did not anticipate its implications, probably due to the poor "quality" of information selectively released to these rivals by law enforcement bureaucracies and their congressional supporters. The only group that suggested problems with the legislation was the Criminal Justice Section of the American Bar Association. Two groups involved in drug therapy (the Therapy Committees of America, and the Alcohol and Drug Problems Association) also supported forfeitures sharing, but proposed that a share also go to drug therapy programs. The law enforcement lobbies prevailed.

Following passage of the initial law, interbureaucratic competition for the rights to seized assets, as defined by federal statutes, intensified. It became clear to state and local bureaucrats who compete with the law enforcement sector for the control of resources that the federal legislation was being used to circumvent state laws and constitutions prohibiting certain forfeitures or limiting law enforcement use of seizures. For example, North Carolina law requires that all proceeds from confiscated assets go to the County School Fund. Law enforcement agencies in North Carolina, and in other states where state law limited their ability to benefit from confiscations, began using the 1984 federal legislation to circumvent their states' laws by routinely arranging for federal "adoption" of forfeitures so they could be passed back to the state and local law enforcement agencies. As education bureaucrats and others affected by this diversion of benefits recognized what was going on, they began to advocate a change in the federal law. They were successful, at least initially: the Anti-Drug Abuse Act of 1988 (passed on 18 November 1988) changed the asset forfeitures provisions established in 1984. Section 6077 of the 1988 statute stated that the attorney general must assure that any forfeiture transferred to a state or local law enforcement agency "is not so transferred to circumvent any requirement of state law that prohibits forfeiture or limits use or disposition of property forfeited to state or local agencies." This provision was designated to go into effect on 1 October 1989, and the Department of Justice interpreted it to mandate an end to all adoptive forfeitures (U.S. House 1990, 166).

State and local law enforcement officials immediately began advocating repeal of Section 6077. Thus, the Subcommittee on Crime heard testimony on 24 April 1989 advocating repeal of Section 6077 from such groups as the

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International Association of Chiefs of Police, the Florida Department of Law Enforcement, the North Carolina Department of Crime Control and Public Safety, and the U.S. attorney general's office. Perhaps the most impassioned plea for repeal was made by Joseph W. Dean of the North Carolina Department of Crime Control and Public Safety (U.S. House 1990, 20–28),[21] who admitted both that law enforcement bureaucracies were using the federal law to circumvent the state's constitution and that, without the benefits of confiscations going to those bureaus, substantially less effort would be made to control drugs:

> Currently the United States Attorney General, by policy, requires that all shared property be used by the transfer for law enforcement purposes. The conflict between state and federal law [given Section 6077 of the 1988 Act] would prevent the federal government from adopting seizures by state and local agencies.
>
> ...This provision would have a devastating impact on joint efforts by federal, state and local law enforcement agencies not only in North Carolina but also in other affected states....
>
> Education is any state's biggest business. The education lobby is the most powerful in the state and has taken a position against law enforcement being able to share in seized assets. The irony is that if local and state law enforcement agencies cannot share, the assets will in all likelihood not be seized and forfeited. Thus no one wins but the drug trafficker....
>
> ...If this financial sharing stops, we will kill the goose that laid the golden egg.

This statement clearly suggests that law enforcement agencies focus resources on enforcement of drug laws because of the financial gains for the agencies arising from forfeitures. Perhaps the stimulus for this practice was not that drugs are illegal, or that the president had declared the war on drugs, which induced the massive post-1984 policy effort against them, but rather the 1984 legislation that mandated that forfeitures generate benefits for police.

The implication that law enforcement agencies benefit from the discretion arising through forfeitures was also corroborated by other testimony, including that of the commissioner of the Florida Department of Law Enforcement (FDLE) (U.S. House 1990, 13–14). In fact, a statement by the U.S. attorney for the Eastern District of North Carolina, in support of repealing Section 6077, actually implied that law enforcement agencies were focusing on confiscations as opposed to criminal convictions (U.S. House 1990): "Drug agents would have much less incentive to follow through on the asset potentially held by drug traffickers, since there would be no reward

21. Recall that North Carolina requires that all forfeited assets go to education.

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for such efforts, and would concentrate their time and resources on the criminal prosecution" (26).

Indeed, forfeitures can be successful even if arrest and prosecution are not. Forfeiture laws are supposedly designed to protect lien holders and owners whose property is used without their knowledge or consent, but owners' rights are tenuous because most states prohibit suits claiming that the property was wrongfully taken. This prohibition, coupled with the fact that the procedure takes place in a civil forfeiture hearing, diminishes the capacity of property owners to defend themselves. Generally, owners whose property is alleged to have been used in a drug offense or purchased with the proceeds from drug trafficking have the burden of establishing that they merit relief from the forfeiture proceeding (National Criminal Justice Association 1988, 41). The owners must prove not only that they are innocent of the alleged crime, but that they lacked both knowledge of and control over the property's unlawful use if someone else used it for criminal purposes. For example, if a drug seller places a drug order by phone from a friend's business, that property can be seized unless the owner proves lack of both knowledge and control. Thus, forfeiture activity can be a lucrative source of revenue for a police agency, without regard for the actual criminality of the potential victim of such seizures. The power of confiscation is shown by a March 1991 drug raid in which federal agents confiscated three University of Virginia fraternity houses after they seized drugs valued at a few hundred dollars. The houses were valued at $1 million, and the rents from these buildings were subsequently paid to the U.S. Justice Department.[22]

Many law enforcement agencies have benefited from asset seizure laws. More than 90 percent of the police departments with jurisdictions containing populations of 50,000 or more and more than 90 percent of the sheriffs' departments serving populations of 250,000 or more received money or goods from a drug asset forfeiture program in 1990 (Reaves 1992, 1). Furthermore, the Drug Enforcement Administration seizes millions of dollars at ports, airports, and bus stations. Congress began investigating alleged abuses by the DEA in May 1992. Indeed, asset forfeiture by law enforcement agencies has become increasingly controversial throughout the nation. Highly publicized criticism in the print and electronic media has raised constitutional issues such as the erosion of Fourth Amendment rights, protection of innocent parties, and the proportionality of punishment to the crime. Whether large portions of the seizures come from criminals or not cannot be determined because many seizures do not involve arrests, and the costs associated with recovering wrongfully seized assets from federal authorities can run into thousands of dollars. Despite widespread misuse of

22. "Turning Drug Busts into a Profit Center," *Washington Post Weekly Edition,* 19 April 1991. In a series of *Orlando Sentinel* articles during June 1992, Jeff Brazil and Steve Berry describe, in vivid detail, the asset seizure program in Volusia County, Florida, which netted over $8 million in four years.

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the forfeiture laws all over the country,[23] however, the police lobbies won the battle over federal legislation. Section 6077 of the Anti-Drug Abuse Act of 1988 never went into effect. Its repeal was hidden in the 1990 Defense Appropriations bill, and the repeal was made retroactive to 1 October 1989. In appears that the police bureaucrats have won the competition over the property rights to forfeitures, at least as it has been waged at the federal level.

Competitors for budgets at the local level may recognize the significant discretionary gains police enjoy as a consequence of asset seizures. If they do, then they might be able to convince local sponsors that police budgets should be reduced accordingly; that is, change procedures so returns from asset forfeiture do not necessarily represent a net gain to local police agencies even when they are given to the agencies. Pressure from other local bureaucrats competing for resources may lead administrators and politicians with whom bureaucrats bargain for agency budgets to view the flow of money from seizures as a substitute for regular budget increments. After all, one alleged purpose of asset forfeitures is to make drug enforcement efforts to a degree self-financing. If these gains are fungible in the budget bargaining and review process, and local commissions, councils, or mayors face strong pressures to take full advantage of this possibility, these officials could refuse to approve police budgets that are not reduced to offset expected confiscations.

Asset Seizures and Police Discretionary Budgets

The extent to which police agencies can increase their budgets via forfeiture activity is explored in Benson, Rasmussen, and Sollars (1995) using data from Florida policing jurisdictions. Confiscations were found to have a significant positive impact on police agencies' budgets after accounting for demand and local government budget-constraint factors. As expected, the impact was larger in more populous jurisdictions. It appears that forfeitures offer police an attractive policy option: an activity that can be justified politically because of its potential strong deterrent effect and because it suggests that drug enforcement is, to a degree, self-financing, while it generates direct benefits to the police bureaucracy by increasing the bureau's discretionary budget. Relatively small amounts of money from seized assets can mean substantial increases in budget discretion.

Florida data provide an indication of the importance of confiscations as a source of discretionary spending. The estimated elasticity of noncapital expenditures with respect to confiscations is 0.04 for all jurisdictions and 0.07 for the larger ones (Benson, Rasmussen, and Sollars 1995), but this seemingly modest elasticity belies the potentially large impact of asset

23. Dennis Cauchon and Gary Fields demonstrated this in a series of articles on "Abusing Forfeiture Laws" in *USA Today*, 18 May 1992. See also Brazil and Berry's commentary in the *Orlando Sentinel* appearing on various dates in June 1992.

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forfeiture on decision making, since only a small fraction of noncapital expenditures is discretionary. The elasticity of discretionary spending with respect to confiscations can be approximated as the estimated elasticity divided by the proportion of all discretionary noncapital expenditures. Thus, if 10 percent of noncapital expenditures are discretionary, the relevant elasticity lies in the 0.4 to 0.7 range. Because the portion of budgets committed to specific uses is probably larger than assumed here, these figures most likely represent a significant underestimate of the impact confiscated assets can have on the discretionary budget. These results, combined with the evidence of more intense drug enforcement after 1984, are consistent with the hypothesis that police have incentives to respond to the Comprehensive Crime Act of 1984 by focusing on drug enforcement.

The asset forfeiture provisions of the federal statute created an exogenous change in state and local law enforcement agencies' bureaucratic incentives, inducing them to join in the federally declared war on drugs. Police agencies seeking to increase their budget discretion were encouraged to use an increasing portion of their resources against drug offenders and to devote fewer resources to other crimes. Thus, changes in police behavior since 1984 are consistent with the proposition that these agencies responded to the incentives created by this law. The relative allocation of state and local law enforcement resources has shifted dramatically toward drug enforcement, the major source of asset confiscations. Therefore, sin taxes continue to be an integral part of public policy toward drug markets, despite the fact that criminalization of narcotics and marijuana has occurred. When a sin is legal the sin tax is called an excise tax; when the sin is illegal the sin tax is called asset seizure or asset forfeiture. Sin taxes are intended to alter the behavior of sinners but, as explained here, the allocation of the resulting revenues can have a dramatic effect on the behavior of the tax collectors. The resulting practice of predatory public finance can be seen by looking at the interstate variation in asset seizure laws and drug enforcement policy.

Differences in Drug Enforcement Across States and Cities

The federal confiscations statute appears to help explain the nationwide conduct of a drug war, but it does not explain the large differences in drug enforcement activities across states detailed in table 1. However, under the federal adoption procedures, federal authorities keep 20 percent of the confiscated assets they handle. Thus, there are incentives for police to avoid federal adoptions if their state laws allow them to keep seized assets, as the laws do in a number of states. In fact, the importance of the federal statute receded by 1990, as many state legislatures followed the federal government's lead and police bureaucrats' demands by incorporating the forfeiture process into their standard law enforcement procedures. Now many more states have

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a forfeiture statute that allows expanded opportunities for seizures and directs the proceeds toward law enforcement. Items most often subject to seizure include material used in drug production, paraphernalia, containers, motor vehicles, and money, but most states now also allow confiscation of real estate used in the "furtherance of illegal drug activity." Only seven states allowed confiscation of real estate in 1984, but statutory changes increased this number to 17 by 1988, and it reached 43 in 1991. Beyond that, a growing number of states have more general forfeiture provisions, allowing seizure for nondrug "contraband" offenses and felonies. State racketeering laws that authorize the forfeiture of property obtained as a result of numerous illegal activities are even more conducive to law enforcement interest. Nonetheless, state statutes are not all as accommodating to police as the federal statute, leaving the federal law a useful vehicle by which many police bureaucracies can enhance their discretionary budgets.

Given the variation in state laws regarding forfeitures and the costs associated with using the federal authorities, it might be that these factors help explain the cross-state variation in drug enforcement activities. Rasmussen, Benson, and Mast (1994) explored this issue using a reduced-form econometric model of the demand for and supply of drug enforcement in a sample of large U.S. cities. Included in the model are variables that control for the extent of drug use, the opportunity cost of police resources, and socioeconomic factors affecting the demand for drug enforcement. The variable of principal interest is the presence of a confiscation law that permits police to keep some of the proceeds from seized assets. They report that the level of drug use, as measured by the percentage of arrestees testing positive for any illicit drug use, is a highly significant determinant of drug arrests. More important for our purposes here, they found that a state law that allows the police to keep any portion of seized assets was associated with significantly more emphasis on drug arrests. Indeed, the laws have a large and important impact on the allocation of police resources: the existence of a confiscation law favorable to the police raises the drug arrests/total arrests ratio between 35 and 50 percent, depending on the model specification. Allowing police to profit from the confiscation of assets from alleged drug offenders apparently provides a powerful incentive to law enforcement agencies, thereby changing agency behavior.

Conclusions: The Drug War Winds Down

Escalation of the war on drugs, when measured by drug arrests relative to Index I arrests, apparently ended in 1989. In the United States the drug arrest/Index I arrest ratio fell from 0.46 in 1989 to a 1990 figure of 0.36, a decline of 24 percent. This decline in drug enforcement is not inconsistent with bureaucratic incentives, however, including those created by asset forfeiture legislation. Police may simply be arresting "smarter," for example, concentrating on drug offenders with some potential yield via forfeiture. For

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instance, if police agencies are seeking seizure opportunities, they are likely to reduce juvenile arrests relative to adult arrests, as youthful offenders are less likely to own property that can be seized. This implication is particularly interesting because, from a theoretical perspective, increasing juvenile participation in the drug trade can be expected during the period of rising drug enforcement. The war on drugs included greater arrest rates for drug offenses, a greater probability of conviction given arrest, and longer sentences, but these increased costs were imposed primarily on adults rather than juveniles, who generally received relatively lenient sentences for identical offenses. Therefore, drug traffickers had increasing incentives to reduce their risk by both lengthening the distribution chain and using more juveniles in the process. Yet, in the United States, persons under eighteen accounted for 11.95 percent of all drug arrests in 1984 but only 7.47 percent in 1990, a 37 percent decline. This reallocation of police effort against drugs is consistent with the hypothesis that police have been increasingly interested in the agency yield from drug enforcement through the seizure of assets. As a high-ranking U.S. antidrug official recently noted: "Increasingly, you're seeing supervisors of cases saying, 'Well, what can we seize?' when they're trying to decide what to investigate. They're paying more attention to the revenues they can get...and it's skewing the cases they get involved in."[24]

It is also possible that opportunities for seizures are being reduced as drug market entrepreneurs adjust to the increasing focus on confiscations. For instance, marijuana growers are increasingly using national forests and other public lands rather than private land because "this technique precludes the use by the government of the legal remedy of confiscation of the land on which the illegal activity is being perpetrated" (Office of the Attorney General 1989, 12). Drug dealers can rent or lease houses, apartments, cars, and other assets rather than purchase them, and hide assets abroad. Indeed, increasingly sophisticated efforts to hide assets (e.g., money laundering) make seizures more and more costly.

Another factor may be the growing recognition that the drug war has not been living up to its billings. Indeed, public opinion in support of the drug war has decreased since 1989. Opinion polls report a consistent public preference for tougher treatment of criminals. But despite this trend, preferences regarding drug policy are becoming much more ambiguous, and they do not necessarily support a law enforcement approach to the problem. Public opinion might be expected to support the continued "get-tough" policies against drugs if claims promulgated by law enforcement interests that such a focus would reduce other kinds of crime were widely accepted. However, it is becoming increasingly clear that the war on drugs is not being won, *and* that the negative consequences of the war are substantial.

24. "Turning Drug Busts into a Profit Center," *Washington Post Weekly Edition,* 19 April 1991, 32.

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Today, for example, many states are wrestling with the prison-crowding problem, which many citizens recognize is at least in part a consequence of the get-tough policies against drugs that occurred during the 1984–89 period, including the large increases in arrests and convictions and the longer mandatory sentences. The Florida legislature was forced to hold a special session in 1993 in order to allocate more funds to prison construction and avoid the "gridlock" that was anticipated late in 1993, when no criminals eligible for early release would remain in the system (many prisoners cannot be released early under statutes regarding habitual offenders and various specific crimes, many of which are drug related), and the 1994 legislature allocated funds to expand the state's prison system by an additional 27 percent. Given recognition that drug enforcement policy is a major determinant of recent trends in prison crowding, and that the drug war has not produced the benefits its supporters claimed it would, public opinion may turn against the drug war.[25] It is clearly the case that the media have begun to focus on some negative consequences of the drug war, and the media's change in focus seems to reflect changing public sentiments.[26]

In the face of apparent growing recognition by taxpayers that the war on drugs has not achieved its exaggerated purposes, police may be reducing their drug control efforts in order to control nondrug crimes. After all, as Breton and Wintrobe (1982, 149) noted, with the passage of time, the perceived responsibility for the failure of a policy (e.g., crime control through the control of drug-market activity) shifts from outside forces (e.g., the drug dealers, the recession, and so on) to the government and, within the government, to the bureaucracy, so pressure arises for bureaucrats to account for what is going on. Indeed, prison officials are now starting to blame the

25. When asked about the most effective way to deal with the drug problem, survey respondents generally favor treatment over incarceration. Fifty-seven percent of survey respondents in 1989 thought building more federal prisons would not reduce illegal drug use, for example, while 80 percent thought more money for drug treatment would be effective. Over 90 percent responded that more spending on drug education in schools would be effective in reducing drug use (Department of Justice 1991, table 2.95). A 1990 Gallup Poll revealed similar skepticism of the efficacy of arresting drug offenders. Only 4 percent believed the most money should be spent on arresting users, and 19 percent thought arresting sellers was the most effective use of resources. In contrast, 40 percent thought early education was the best way to combat drug use (treatment to overcome addiction was preferred by only 5 percent of respondents in this poll, however; Department of Justice 1991, table 2.96).

26. For example, the *Tallahassee Democrat* has picked up a number of stories from other newspapers and news services with themes such as those in the following sampling: (1) from Knight-Ridder's Washington Bureau: Aaron Epstein, "Tide of Opinion Turns against Harsh Sentencing for Drug Offenders," 7 May 1993, 4A; (2) from the Associated Press: Michael White, "Cases Indicate the War on Drugs May Be Overdoing It," 2 November 1992, 3A; (3) from the *Chicago Tribune*: Jon Margolis, "Punishment Should Fit Drug Crime," 5 July 1991, 15A; and (4) from the *Miami Herald*: Ronnie Greene, "Skip Town, Judge Tells Drug Suspect," 8 October 1992, 4C. Further, asset seizure policies have received significant negative coverage. It is not obvious whether the media are leading or following public opinion in this regard.

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war on drugs for the consequences of their early release programs. Consider the example of Frank Potts, who was released from the Florida prison system in 1988, after serving six years of a fifteen-year sentence for molesting an eleven-year-old girl, despite the report of a parole examiner who noted there was a very high probability of recidivism if Potts was released. He is now being held on charges of molesting another eleven-year-old girl, but in addition an intense investigation is underway regarding allegations that Potts has killed as many as thirteen people. A Florida Department of Corrections spokesperson explained the early release by noting that "the agency is bound by mandates from the courts and the legislature. In the mid-1980s, the prison system was inundated with inmates carrying minimum mandatory sentences during the country's initial skirmishes in the war on drugs."[27] Thus, policies tend to cycle. An uninformed public can be misled by bureaucrats and policymakers for a while, as the agencies push their own agenda, but if the policy does not work it will ultimately have to be altered in recognition of its failure. This does not mean that a rollback to the pre-1984 level of drug enforcement is to be expected, but it does suggest that the increase in drug enforcement over the 1984–89 period cannot be sustained indefinitely.

Another important consideration for police in their increasing emphasis on nondrug crime after 1989 is that "a growing number of states, such as Texas, Florida, and New Jersey, apply their forfeiture laws to any criminal activity" (Reed 1992, 2). Police have learned from their drug forfeiture experience that seizures can be very lucrative. The 1984 federal statute pertained to drug crime alone, but with changes in state laws, forfeitures are increasingly targeted at property owners in general, not just criminally culpable property owners engaged in drug market activities. A family home is fair game in some jurisdictions, for instance, if anyone (e.g., a son, relative, or friend of the owner or of the owner's family) uses the property unlawfully. But the spread of forfeiture activities to nondrug crime areas means "that property owners must police their property against all such activity, drug related or not" (Reed 1992, 2). In effect, property owners are being forced to act for the police in preventing all sorts of crimes on their property, and failure to do so can result in a very high tax—forfeiture of the person's property. With the ever-broadening scope of forfeiture possibilities, drug activity may become a less important target of police efforts, at the same time as it is probably becoming a more difficult target to attack and a politically less viable policy to stress. Thus, a relative winding down of the drug war appears to be the product of the same forces that led to its escalation: changing incentives that affect police bureaucrats, including the opportunity to collect sin taxes from sins other than those associated with drug markets.

27. Associated Press, "Probe: Potts Granted Early Release," *Tallahassee Democrat*, 10 May 1994, 5B.

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Information Asymmetries in Health Services

The Market Can Cope

STEPHEN SHMANSKE

According to mainstream health-care economists, special properties of health service delivery—adverse selection, moral hazard, asymmetric information, monopoly, ethical concerns, and agency—make health care different from other goods (Carlstrom 1994). Economists claim that because of these properties, private competitive markets cannot provide health care efficiently. Various nonmarket institutions and government interventions have been put forward on a piecemeal basis to remedy the alleged market failures.

Unfortunately, because the various problems are interrelated, the interventions often work at cross-purposes, and therefore consumers suffer. For example, one type of asymmetric information occurs because the doctor typically has knowledge the patient does not—that's why the patient sees the doctor in the first place. Ostensibly to protect the patient from charlatans, governments enforce licensing provisions overseen by state medical associations. This industry self-regulation, however, gives rise to other problems: impeded entry, lessened competition, and stifled innovation.

Indeed, government's attempts to fix one problem often make others worse. The interventions exacerbate problems not because those who design the interventions have bad intentions but because they fail to appreciate and take properly into account economic scarcity. If the market really is failing, then perhaps some technical intervention such as price control, a tax, or a subsidy is warranted. But such measures do nothing to alleviate scarcity. In

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fact, these measures consume resources, because they are costly to impose and, on the other side, to avoid or render less burdensome.

My argument here is that several of the alleged market failures in the provision of health services actually reflect economic scarcity. Hence they are best dealt with by market institutions, not government interventions. I shall focus on asymmetric information that leads to adverse selection and moral hazard in health insurance markets, and on possible conflicts of interest in the doctor-patient relationship. The problems that arise in these areas are not really market failures that warrant government intervention. Rather, these problems arise because of economic scarcity and can be dealt with most efficiently through free-market institutions. The common interpretation of these problems as market failures evinces a fundamental misunderstanding and misapplication of basic economics.

I shall proceed by first explaining briefly the conventional wisdom underlying the market-failure claims associated with asymmetric information, then showing how the claims arise from naïveté about the meaning of market efficiency and the roles played by markets and governments in alleviating scarcity.

Adverse Selection

Adverse selection arises when heterogeneous buyers of insurance have information about their own risk that the seller does not have. If the seller prices the insurance at the average cost of insuring a whole group, then consumers in that group who would impose less than the average cost balk at purchasing coverage.[1] Because the rest of the population will impose above-average cost, the insurer will have to raise the price, causing additional customers to decline the coverage. In equilibrium, only customers with the highest expected costs (as well as the most risk-averse) buy full coverage. A secondary market supplying partial coverage to those who decline to transact in the higher-priced market may develop in what is called a "separating equilibrium." Or, under some conditions, there may be no equilibrium in the simplest sense (Rothschild and Stiglitz 1976).

The market equilibrium, or lack thereof, that develops does not match the equilibrium that would be reached if the seller knew everything the individual buyers know about their risk. With symmetric information, a seller would charge each customer his or her expected cost, and the risk would be fully transferred from insured to insurer. Once transferred, the risks would be eliminated through diversification by the pooling of a large number of independent risks.[2]

1. Actually, some such consumers, if very risk-averse, may buy the insurance even at an actuarially unfair price.

2. For a different application of adverse selection, in the setting of employer-offered "multiple choice" programs, see Feldman and Dowd (1991), Marquis (1992), and Jones (1990).

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Some economists say that the market fails because the market equilibrium (or lack thereof) under asymmetric information is inferior to the equilibrium under symmetric information. Sure enough, this is true when one supposes that information can be acquired costlessly, all risks are transferred and insurance coverage is complete; and in real markets, in contrast, coverage is incomplete. But it does not follow that this difference in outcome signifies a market failure.

The ideal of the equilibrium under the condition of symmetric information is irrelevant when in fact it is costly to transfer information credibly. Claiming that the market fails in this instance is akin to claiming that gasoline markets are inefficient because the market price is higher and the quantity sold lower than the corresponding amounts in a model where crude oil is free. When a model assumes that information transfer (or crude oil) is free, the model's optimum is conditional on that assumption. To apply such a model to actual conditions, finding a discrepancy between the model's optimum and actual outcomes, is to misapply the model, not to identify a market failure.

Adverse selection does not cause a market failure; it merely manifests an actual underlying problem, which is the scarcity of information. Useful information, like crude oil, is costly to obtain. When market participants do not have complete information, the market will not—and should not—operate as it would if information were costless. The difference is not indicative of market failure in any helpful sense.

My point is not merely semantic. If a genuine market failure exists, then conceivably the government—given sufficiently low costs of its own actions and barring any distinctive failures of its own—might intervene in a helpful way. But if the market is not failing in the first place, there is no possibility of advantageous intervention.

If the problem is scarcity, how can government intervention help? Government can use its coercive power to alter a market equilibrium, of course, but if it does so, two new problems arise.

First, government officials receive no feedback creating an incentive for them to innovate, produce, conserve, or do anything else to alleviate the scarcity. In contrast, in the private sector the profit motive encourages people to use resources efficiently; losses and bankruptcy punish those who waste resources. Competition guarantees that market participants cannot just ignore these incentives. Therefore, the obvious direct approach to dealing with problems of scarcity is to allow profit seeking in free markets with private property.

A second problem is that, even in traditional cases of market failure, government coercion may be unnecessary as a means of bringing about mutually gainful improvements. Voluntary bargaining, contracting, and exchange can often overcome problems associated with externalities (Coase 1960), free riding (Coase 1974; Brubaker 1975), and public goods (Shmanske 1991).

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Governments that do intervene often make a fundamental error. They naïvely attempt to impose some condition derived from a simplified, irrelevant model. For example, because an attribute of the symmetric information equilibrium is that everyone gets insurance, governments make full coverage a goal to be achieved through intervention. Curiously, full coverage can be achieved at a price equal to the average cost if neither side has information about individual risks. The government can impose this solution by forcing everyone to buy insurance at the average cost (universal coverage) or, alternatively, by prohibiting either side from gaining access to information in the first place.[3] But forcing this one aspect of the unattainable symmetric-information equilibrium is as ill advised as fixing the price of gasoline equal to the price calculated from a model that assumes crude oil is free. A theoretical optimum calculated from a model that assumes away the cost of information is the wrong condition to seek.

The free market's own equilibrium is the right one. It creates the proper incentives to innovate or discover low-cost ways to signal the relevant information so that it can be put to use. Most fundamentally, what is needed to ameliorate the problem of scarce information is entrepreneurship that reduces the cost of information transmission. Government intervention does not fulfill this need; indeed, the intervention hinders the fulfillment by displacing genuine entrepreneurship (Kirzner 1973). Consider just one example of the market's ability to credibly transfer information about individual health risks: employee groups can negotiate low group rates for insurance because the individual risks in the group are diminished by diversification with other members of the group, and also because steady employment itself may signal below-average health-care costs.

In a free-market equilibrium, a degree of adverse selection remains because it is never costless for the insured to signal all relevant private information. This degree, however, is optimal: it is the amount from which further reductions in adverse selection would cost more than they are worth.

In sum, government intervention to "solve" the problem of adverse selection fails to confront the true problem. Moreover, it creates a new problem of inefficient incentives, known as moral hazard.

Moral Hazard

Moral hazard occurs in health-care markets when a third party, usually an insurance company or the government, pays for the service received by the patient. Patients will continue to consume services as long as they value the additional service at more than the additional cost they bear. If a third party pays all or part of the cost of additional care, consumers will demand more care than they would otherwise. In the standard graph used in economic

3. In the debates about the ethics and efficacy of genetic screening, some argue that we might be better off without certain information (Knudson 1994).

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analysis, this overconsumption of service appears as a movement down a given demand curve to a quantity greater than that corresponding to the equality of demand price and (all) marginal cost. This inefficiently excessive use of services is a problem, but moral hazard is a separate compounding problem.

The moral hazard arises because the consumer who pays only part or none of the marginal cost of services will knowingly take unhealthful actions and eschew healthful ones. As a result, the consumer's health worsens, which leads the consumer to want more care. Graphically, the demand curve for care shifts outward from its original position. For example, smokers who are nearly indifferent about whether they should continue to smoke or quit will be more likely to continue smoking if they expect the costs of future smoking-related illnesses to be paid wholly or partly by a third party. In another example, sixty-four-year-old persons, knowing that their health-care costs will be paid next year by Medicare, may delay treatment that otherwise they would seek now, thereby exacerbating the difficulty and cost of their (later) treatment. Thus, moral hazard encompasses both sins of commission and sins of omission. In either case, health-care costs rise.

Increased costs for the third-party payer ultimately have to be borne by consumers either as taxpayers or as premium payers. If the insurer can adjust premiums to make high-volume users pay extra, then some incentive to restrain demands for service is restored to the system. This restraint enhances efficiency, as it causes individuals to take precautionary actions such as exercising or quitting smoking when they value the premium reductions more highly than the alternatives forgone. If the premium is set at average cost regardless of the behavior of the individual insured, then no one has an incentive to take further precautionary measures. To the extent that the problem of adverse selection is treated by placing all the insured into the same pool and charging each person the average cost of coverage, the problem of moral hazard grows worse.

One market attempt to overcome moral hazard is the creation of the health maintenance organization (HMO), in which the third-party payer and the health-care provider are the same. In this setup, excessive demands for service can be monitored and overconsumption forestalled. The system has its critics, however, because it creates a conflict of interest between the doctor as care giver and the doctor as residual claimant.[4]

Typical government attempts to control overconsumption involve prioritization of allowable procedures (Fox and Leichter 1991), rationing by waiting (Miyake and Walker 1993; Iversen 1993), other nonprice rationing techniques, and, if quantity controls fail, price controls, which were a central feature of the Clinton administration's proposals for national health-care reform in 1994. Such interventions have well-known deleterious effects.

4. For statistical evidence on the ability of HMOs to reduce costs, see Olsen (1993).

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Further, by dealing with the symptoms (high costs and excessive consumption) instead of the cause (asymmetric information between the patient and the third-party payer), government interventions mask the basic issue of economic scarcity, thereby inhibiting and delaying proper understanding and solution of the problem.

The straightforward, if naïve, solution for moral hazard is to dispense with third-party payers. People who must pay for their own health care will not overconsume it. But this solution conflicts with the desirability of an insurance market to shift and spread risks. Individuals may not want to pay for their health care out of pocket because of the uncertainty about how much that will cost; hence they demand insurance to smooth their expenditures for health care. Unfortunately, moral hazard attends this solution. Moral hazard, however, should be seen as simply another aspect of economic scarcity.

Presumably, market participants will try to develop arrangements (HMOs, copayments, deductibles) that reduce the overconsumption arising from moral hazard so long as the expected gains exceed the expected costs of doing so. This sort of innovation is tricky, however, because although the insurer is willing to pay for health-care costs that are truly unexpected by the individual insured—the reason for insurance in the first place—the insurer does not want to bear costs arising from overuse prompted by the payment arrangement. Similarly, the insured is willing to pay premiums that cover the risk of unexpected health-care costs but prefers an arrangement without built-in incentives for overuse for which consumers ultimately must pay. Both the insurer and the insured want risk transfer without moral hazard. Unfortunately, economic scarcity makes it inherently costly for the insurer to distinguish between desirable and undesirable expenditures to care for the insured and inherently costly for the insured to credibly commit to avoid overconsumption. Given the underlying scarcity and hence the costs of the relevant information, in equilibrium some moral hazard remains. But inasmuch as further reductions in moral hazard would cost more than they are worth, the remaining moral hazard is the efficient amount.

It is crucial that one distinguish between, on the one hand, an optimal insurance contract voluntarily entered into by both parties and including a mutually agreed amount of signaling and monitoring and, on the other hand, an imposed socialization of health risk through government insurance. The latter may eliminate adverse selection, yet it will fail nonetheless if excessive moral hazard causes skyrocketing costs. Voluntary coverage will not achieve universal coverage, nor will it completely eliminate adverse selection and moral hazard, but the amounts of coverage, adverse selection, and moral hazard will be economically efficient.[5]

Although no one knows for sure, a type of contract still awaiting discovery may simultaneously permit risk sharing, avoid adverse selection, and

5. For recent theoretical work on the optimal contract, see Stewart (1994).

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control moral hazard. The likelihood that it will be discovered is greater if buyers and sellers in health-care markets are allowed to transact freely. People can experiment with many types of contracts and arrangements simultaneously in the market process. But imposition of a one-size-fits-all government program puts all the eggs in one inflexible basket determined by its political viability. To suppose that the one "best" government program awaits discovery by the brightest minds with the best information is to ignore economic scarcity. In reality, the relevant information to achieve optimal health-care delivery is dispersed among doctors, patients, and insurers and changes over time. The relevant information cannot be gathered in one place at one time to achieve a permanently optimal universal arrangement (Hayek 1945). To suppose otherwise is to commit what Friedrich Hayek called the "fatal conceit" (Hayek 1988).

The Doctor-Patient Relationship

Asymmetric information usually affects the doctor-patient relationship. As a rule the doctor has relevant information that the patient lacks. Therefore, conventional wisdom tells us, markets fail to operate efficiently. Buyers and sellers cannot trade efficiently if one side of the transaction can be manipulated or charged excessively because of inferior information.

Again, however, it is unwarranted to conclude that the actual market fails because the outcome is different in a model with no asymmetric information. Such comparisons are irrelevant and commit the nirvana fallacy. In reality, information can be credibly conveyed across an exchange relationship only at some cost. Comparing the market solution with the solution in a model without such costs tells us nothing of value.

The information asymmetry in the doctor-patient relationship is simply another case of scarcity with which the market can cope. If allowed to do so, individuals interacting in markets continually discover new ways to transfer information and police those who might attempt to exploit less-informed trading partners. For example, with repeat purchases and long-term relationships at stake, the market will reward doctors who can verify that they honestly convey their private information; it will punish those seen to exploit their patients. There is nothing unique about asymmetric information between doctors and patients, as sellers and buyers often have asymmetric information. Getting a second opinion in health-care markets is comparable with comparison shopping in other markets, yet no one claims that markets fail because prudent buyers of clothing expend time, effort, and resources shopping or because would-be homebuyers order termite inspections.

Ostensibly to make sure that all practicing doctors are competent to provide medical care, governments require them to graduate from an accredited medical school and to be licensed to practice by a state board. Although these requirements may weed out the most grossly unqualified—at

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the cost of excluding others who are or could be qualified—they have two serious defects. First, the patients still have no guarantee that competent, licensed doctors will not use their informational advantage for personal gain. Second, the licensing may lull the patients into a false sense of security that leaves them more susceptible to exploitation.

The first drawback exemplifies what is known as an agency problem. Agency theory applies whenever someone, called the principal, wants to do something and arranges for another person, called the agent, to accomplish or help accomplish the task. In general, the agent has different motivations, desires, and information than the principal and, as a result, will not carry out the task exactly as the principal wishes. In view of this agency problem, principals must bear costs either to monitor the agents or to establish incentives for agents to perform more appropriately in the absence of direct monitoring.

Agency theory in the context of the doctor-patient relationship has been discussed by Gavin Mooney and Mandy Ryan (1993). Here the principal is the patient who wants to obtain health care. The patient hires an agent, the doctor, who may have motivations other than providing the optimal amount of service at the lowest feasible price. The doctor's personal motivations may lead to ordering extra tests mainly to earn money or protect the doctor from potential legal liability; to prescribing more expensive drugs, to gain favor with pharmaceutical companies; and to using reciprocal referrals to specialists in other fields, to increase income.

Again, the market develops and encourages the further development of contracts and other arrangements to cope with the agency problem. As long as the principals and the agents are free to negotiate with each other and free to withhold either their services or their business, market incentives will lead people toward efficient outcomes. Government intervention cannot help. Any forced intervention that helps could have been agreed to voluntarily by the parties. But intervention can easily make transactors worse off by forcing an interaction that either the principal or the agent does not want or by prohibiting mutually agreeable interactions that the parties do want.

Licensing provisions do not meet the patient's need for information to determine whether the physician is providing the correct treatment. Instead, licensing attempts to take the problem out of the patient's hands by assuring that all doctors will always provide proper treatments. At best, this arrangement solves the problem incompletely. To be sure that they are not being exploited, patients still must bear costs to find out about the care they are purchasing. The information they need is valuable to them, costly to obtain and, presumably, if the market is not impeded, will be supplied efficiently. Absent the present system, perhaps something akin to the quality-rating agencies in other industries, funded by patients' groups, would flourish. At present, government-enforced licensing reduces the vigor

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with which private means of information generation are pursued.[6] If patients rely on information supplied by governments or physician-sponsored groups, they are likely to lose all the close calls.

Conclusion

Economics has been called the dismal science because economists so often point out to consumers, providers, or policymakers that people cannot magically satisfy their desires if scarcity dictates otherwise. One can ignore scarcity, hiding costs or shifting them to the benefit of some and the detriment of others, but the basic constraint of scarcity remains. Those who call attention to such economic realities are often labeled naysayers or curmudgeons, and sometimes the discussion never gets beyond shallow analysis, name-calling, and political maneuvering. But the problems remain. Far from being solved, they are not even properly confronted by existing or proposed policies.

It is fashionable to interpret any unfortunate human experience as a case of market failure. Intellectuals often invoke this interpretation to justify government intervention. Sad to say, the practice of claiming market failure and proposing interventionist policy has become so established that many discussants have forgotten to attend to the fundamental issue of economics, namely, scarcity. But if scarcity is the underlying cause of a problem, this approach is doomed to fail. The best that society can do is to balance costs against benefits at the margin. The market is the institution in which the individuals who actually experience the costs and benefits undertake such balancing. In health services, asymmetric information arises from economic scarcity, because—like it or not—information is costly to obtain and credibly transmit. Government policies ignore or attempt to hide these costs. The market allows, indeed requires, people to confront them directly and creates incentives for dealing with them efficiently.

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6. For a more general model of government preemption of private activity, see Shmanske (1996).

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New Deal Nemesis

The "Old Right" Jeffersonians

SHELDON RICHMAN

> "Th[e] central question is not clarified, it is obscured, by our common political categories of left, right, and center."
>
> —CARL OGLESBY, *Containment and Change*

Modern ignorance about the Old Right was made stark by reactions to H. L. Mencken's diary, published in 1989. The diary received extraordinary attention, and reviewers puzzled over Mencken's opposition to the beloved Franklin Roosevelt, to the New Deal, and to U.S. entry into World War II.[1] Robert Ward's review (1989) was typical. Unable to fathom "Mencken's strange blindness regarding World War II" and his "near pathological hatred of...Roosevelt, whom he regarded as a mountebank," Ward wrote as though no one else in Mencken's America shared those views. He went on to say: "Mencken seemed actually to think that Roosevelt simply conned the United States into entering the war in order to make himself a hero.... Of course, this is shocking and untrue...." (3).

Even Charles A. Fecher, the editor of the diary and a Mencken scholar, could not believe what he read.

> His feelings about World War II are incredible in a man of his intelligence, knowledge, and perception.... The whole obscene show is simply "Roosevelt's war." ...And the war was far from being the only thing for which he blamed him. His hatred of Roosevelt was, indeed, maniacal—there is no other word to use.... It is hard

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1. Nearly everyone, including Ronald Reagan and Newt Gingrich, feels obliged to pay tribute to Roosevelt.

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> to ascribe this hatred to ideology. [I]t may well be that he sensed Roosevelt was ushering in a new era of social history...and Mencken, deeply conservative, resentful of change, looking back upon the "happy days" of a bygone time, wanted no part of the world that the New Deal promised to bring in.[2]

Thus Mencken's opposition to Roosevelt was dismissed—by a man who knew the writer's thought intimately—as the blind fear of change. In this introduction and in most of the commentary on the diary, Mencken was uniformly treated as a lone, idiosyncratic bigot, whose hatred of FDR and the war, if it was to be explained at all, could be the product only of racism and anti-Semitism. One would never glean from these reviewers' astonishment that something approaching a principled national political movement coalesced in opposition to Mencken's twin bugaboos, the New Deal and U.S. participation in the war, and to the man responsible for them, Franklin Roosevelt.[3]

But in fact, H. L. Mencken was not alone, however much he may have felt so. He was joined by a group of people from a variety of occupations—but primarily from politics and journalism—and political backgrounds. They, of course, didn't think of themselves as the "Old Right." That term would not have meaning until a "New Right" arose in the 1950s. Nevertheless, beginning roughly in the mid-1930s, a distinctly identifiable political coalition began to form, consisting of politicians and publicists alarmed by the growth of bureaucratic power in the hands of the national government's executive branch. A distinctive feature of the coalition was its willingness to apply this concern to foreign as well as domestic policy. This rising opposition foresaw danger for the Republic in both realms, and counseled a return to first principles: the U.S. Constitution, separation of powers, checks and balances, decentralization, limited popular rule, individual autonomy; in a word, republicanism. Thus the issue ultimately raised by the umbrella group now known as the Old Right was whether America would remain a land of limited government and individual freedom and initiative, or whether traditional American ideals would be subordinated to a government of unlimited executive power guided by collectivism at home and imperialism abroad—in short, republic versus empire.

The Old Right began as a group of people with disparate backgrounds but awakened by a common threat: Franklin Delano Roosevelt and his

2. Mencken 1989, xvi–xviii. Fecher's own book on Mencken is *Mencken: A Study of His Thought* (1978).

3. This is not all Fecher got wrong. He wrote that the anti-Semitic rabble-rouser Gerald L. K. Smith founded the America First Committee. Smith was not even a member, much less the founder. The league actually shunned Smith and other known anti-Semites. Fecher is confused: in 1943 Smith founded the America First Party; by then the America First Committee was defunct and had no direct connection with the party. See Cole 1971, 134, 188.

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unprecedented accretion of executive power.[4] That the movement was placed on the right or called "conservative" has to be regarded a quirk of political semantics.[5] In a superficial sense it qualified as right-wing because it seemed to be defending the status quo from the state-sponsored egalitarian change of the New Deal. But in a deeper sense, the New Deal actually was a defense of the corporativist status quo threatened by the Great Depression. Thus the Old Right was not truly right-wing, and since that is so, it should not be bothersome that some palpable left-wingers, such as Norman Thomas and Robert La Follette, Jr., seemed at home in the Old Right.[6]

The Old Right includes several identifiable strands: "progressive" isolationists (such as Senator William Borah and John T. Flynn), Republican "conservative" isolationists (such as Robert Taft), libertarian and individualist iconoclasts regarded as leftist radicals in the 1920s (Mencken and Albert Jay Nock), conservative Democrats (such as Senator Bennett Champ Clark), World War I revisionists with a social democratic background (such as Harry Elmer Barnes), social democratic opponents of Roosevelt's foreign policy (such as Charles Beard), a trio of individualist women writers (Ayn Rand, Rose Wilder Lane, and Isabel Paterson), a group of free-market liberal economists and journalists (such as Frank Chodorov, Garet Garrett, Leonard Read, F. A. Harper, and no doubt others), and some individual members who defy classification.[7] The categories overlap, but they indicate the diversity.

Some Old Rightists opposed FDR from the start; others inclined toward him, and even supported him, during the election against Herbert Hoover in 1932 and during the first years of the New Deal. They had different rationales for their opposition to the domestic and foreign policies of the 1930s: some were nationalists and unilateralists, others pacifists and classical liberal internationalists in the Richard Cobden tradition.[8] But sooner or later they united in opposition to the actions and the tone of Roosevelt and his Brains Trust. As time went on, the group seemed to draw closer together temperamentally and even philosophically, perhaps in response to the government and the media's overwhelming opposition to it.

4. The latest study of the Old Right is Justin Raimondo's *Reclaiming the American Right: The Lost Legacy of the Conservative Movement* (1993).

5. As Jerome L. Himmelstein (1990) points out, the nineteenth-century conservatives were those who resisted "the major features of modern Western society—industrial capitalism, political democracy, and an individualist culture—in the name of an agrarian, aristocratic, communal social order. Liberal referred generally to support for those same changes" (26).

6. On America's corporativist history and the New Deal as a defense of corporativism, see Kolko (1963), Bernstein (1968, 263–288), Radosh (1972, 146–87), Rothbard (1972a), and Hughes (1977). See also Ekirch ([1955] 1967), Higgs (1987), and Vedder and Gallaway (1993).

7. The late Roy A. Childs, Jr., suggested the categories.

8. On the various motivations in foreign policy, see Carpenter (1980, 4–5).

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The dissimilitude of the strands making up this political braid illustrates that the term *Old Right* does not denote a precise political architectonic. Most of its members were not of a philosophical bent; rather, they were journalists and office-holders, reacting to events. They were serious thinkers, but for the most part not systematizers. Unsurprisingly, they had disagreements on particulars, especially those pertaining to affirmative ideas. But they knew what they didn't like.

Old Rightism was a frame of mind, a spirit rather than a rigorous philosophy. Its anima was an intransigent individualism in the face of a torrent of collectivism at home and outright dictatorship abroad. Even after the Republican Party establishment accommodated itself to the New Deal in the 1950s, the Old Right pressed the fight. In its particulars, this group held a deep respect for the founding ideals of the United States, namely, the principles of the Declaration of Independence, the Constitution, and a few other documents, such as Washington's Farewell Address. If the Old Rightists had a single hero it would have been Thomas Jefferson. They may not have agreed exactly on what he believed, but they would have endorsed Mencken's view that "Jefferson would have killed himself if he could have seen ahead to Roosevelt II" (1956b, 78).

Their common bogey was power. Concentrated power nullified the autonomous individual; unchecked bureaucracy was an octopus run amuck, its multiplying tentacles strangling what had made America vital. Most would have applauded Henry David Thoreau's observation made in "Civil Disobedience": "Yet this government never of itself furthered any enterprise, but by the alacrity with which it got out of the way" (Bedau 1969, 27), and for most, their aversion to power was especially pronounced in foreign affairs—so much so that this is emblematic of the Old Right.[9] Here all their principles intersected with a vengeance, resulting in a white-hot contempt for secret diplomacy, intrigue, foreign entanglements, imperialism, and their sine qua non, the independent, discretionary presidency—what has been called the Executive State.[10] To the Old Rightists, these practices were unconstitutional intrusions on the prerogatives of the people and of the people's representatives—intrusions worth fighting even when the Old Rightists themselves happened to agree with a particular objective. They also understood that private diplomacy was likely to lead to war, that great

9. See Rothbard 1978. Rothbard aptly emphasizes the Old Right's connection to the English Manchester Schoolers Richard Cobden and John Bright and the leading American disciple of Herbert Spencer: William Graham Sumner (86). He also points out that confusion over the terms *Left* and *Right* came from the flip–flop of so many liberals and leftists on the war question in the late 1930s and the recrimination against liberals who stayed the noninterventionist course, such as Harry Elmer Barnes, John T. Flynn, and Oswald Garrison Villard (86–88). This change is painstakingly chronicled in Martin 1964. For a discussion of the regional rivalry between midwestern and eastern business interests, see Rothbard 1978, 88.

10. Compare this attitude with the occasional conservative posturing about the "imperial" Congress's "micromanaging" foreign policy at the expense of presidential prerogative.

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scourge of a free society. War, they believed, always resulted in all manner of government control: of the economy, of personal liberty, of the press—the things that must be left unmolested if the dignity and freedom of the individual are to be preserved. This was not high-flown theory for them, but the lessons of the past, most recently World War I, the great leap toward collectivism in America (Rothbard 1989).

Their opposition to war stemmed also from what it would likely do to the rest of the world.[11] Herbert Hoover and Robert A. Taft, during their food-relief efforts in Europe after World War I, understood that Bolshevism came to Russia only after the United States prevailed on the Provisional Government to stay in the war, despite the Russian people's abhorrence of that course. They concluded, according to the historian Leonard P. Liggio (1973), that "Bolshevism was the natural result of the dislocation of war, and they shared the fear that intrigues of the European Allies would sustain that dislocation and permit a wider appeal for Bolshevism" (4). Later they observed that the hardship imposed at Versailles had led to Nazi electoral victories.[12] Viewing the war, the vindictiveness of its participants, and the resulting famine, Hoover said, "Famine is the mother of anarchy," which in turn could only encourage the rise of Bolshevism (Patterson 1972, 76). He set up his famed Hoover Institution for the Study of War, Revolution and Peace precisely to study the connection between war and the rise of totalitarianism. Taft, Hoover, and others recalled this lesson as World War II approached, and when the war was over they felt grimly vindicated as the United States immediately embarked on the Cold War (Editorial 1981, 6; see also Doenecke 1982, 203).

In trying to define the Old Right, one historian emphasizes the negative:

> The Old Right, which constituted the American Right-wing from approximately the mid-1930's to the mid-1950's, was, if nothing else, an Opposition movement. Hostility to the Establishment was its hallmark, its very life-blood. In fact, when, in the 1950's, the monthly newsletter *Right* attempted to convey to its readers news of the Right-wing, it was of course forced to define the movement it would be writing about—and it found that it could only define the Right-wing in negative terms: in its total opposition to what it conceived to be the ruling trends of American life. In brief, the Old Right was born and had its being as the opposition movement to

11. Thus it is wrong to say that the Old Right cared only about what intervention would do to America, as the conservative syndicated columnist Patrick Buchanan has said on television talk shows.

12. See "Editorial" in *Literature of Liberty* 1981, 4. See in the same issue, Justus D. Doenecke's article "The Anti-interventionist Tradition: Leadership and Perceptions," 7–67. Also of interest by Doenecke are his article "American Isolationism" (1982) and his book *Not to the Swift: The Old Isolationists in the Cold War Era* (1979).

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> the New Deal, and to everything, foreign and domestic, that the New Deal encompassed: at first, to burgeoning New Deal statism at home, and then, later in the '30's, to the drive for American global intervention abroad. Since the essence of the Old Right was a reaction against runaway Big Government at home and overseas, this meant that the Old Right was necessarily, even if not always consistently, libertarian rather than statist, "radical" rather than traditional conservative apologist for the existing order. (Rothbard n.d., 2–3)

As the Old Right passed from the scene in the mid-1950s (for reasons to be discussed later), it was supplanted by a New Right, a group of intellectuals associated with William F. Buckley, Jr., and *National Review* magazine (founded in 1955). This raises a question: Is one justified in speaking of an old and new right? And if there is a New Right, is it an essentially different movement or a new evolutionary stage of the old? Paul Gottfried and Thomas Fleming, in *The Conservative Movement* (1988), treat the right as essentially one continuous movement, and thus fail to recognize it as an amalgam of many conservative and libertarian elements.[13] They use the term *old right* only when they come to "the emergence of two new conservative forces": the neoconservatives and the "populist and religious New Right" (Gottfried and Fleming 1988, 59). An implication of their position is that the "Buckley Right" is merely the "Taft Right" after a postwar evolution.

One can get this impression because of Buckley's own ties to the Old Right.[14] But this cannot be satisfactory. To insist on this account is to ignore a virtual fire wall between the Taft right and the Buckley right. Many in the Old Right—including Taft, Nock, and Chodorov—rejected the label *conservative*, regarding it as a left-wing smear word (see Rothbard 1968a, 50; Crunden 1964, 174; and Liggio 1973). Taft's official biographer reports that "Mr. Republican" was uninterested in Russell Kirk's book *The Conservative Mind*. "Taft lacked many of the characteristics often assigned to the 'conservatives' with whom he was conveniently lumped" (Patterson 1972, 330). Although Patterson writes that Taft ultimately "was conservative in the practical sense ordinarily applied to mid twentieth-century American politicians," that is, Taft favored limited government, he ends by calling Taft's philosophy "libertarian" (332–33). On the eve of U.S. entry into World War II, Taft indicated who the real conservatives were: "The most conservative members of the party—the Wall Street bankers, the society

13. See also William Rusher's article "Who Ended the Cold War?" which appeared in the *Washington Times*, 15 December 1989. George H. Nash (1976) disagrees to an extent (123–30), though the title of his work, *The Conservative Intellectual Movement Since 1945*, implies there was essentially one continuous movement. For a similar view, see Himmelstein 1990, 28ff.

14. In earlier days, Buckley was a member of the America First Committee and a disciple of Nock and Chodorov.

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group, nine-tenths of the plutocratic newspapers, and most of the party's financial contributors—are the ones who favor intervention in Europe."[15]

The Old Right was temperamentally different from the group associated with Buckley, many of whom were former Trotskyists and advocates of some variant of coercive communitarianism. What was new about this New Right? Clearly, it was the Cold War temperament and the shift in emphasis from individualism to government promotion of virtue. This can be summed up handily as the transmogrification of "Our Enemy, The State" (to use Albert Jay Nock's title) into "Statecraft as Soulcraft" (to use George Will's).

> Where once the Right was fervently devoted to the freedoms propounded in the Bill of Rights, it now believes that civil liberties are the work of Russian agents. Where once it stood for the strict separation of Church and State, it now speaks of the obligation of the community to preserve a Christian America through a variety of Blue Laws and other schemes for integrating government and religion. Where once the Right was, above all, dedicated to peace and opposed to foreign entanglements, it now is concerned with preparing for war and giving all-out aid to any dictator, Socialist or otherwise, who proclaims his unbending "anti-Communism." Where once the Right wanted America to exert its moral effect upon the world by being a beacon-light of freedom, it now wants to turn America into an armed camp to crush Communism wherever it appears. (Hamowy 1961, 4–5)

The New Rightists' own words demonstrate the discontinuity between old and new. In a 1952 article, Buckley called for "extensive and productive tax laws...to support a vigorous anti-communist foreign policy." Because of the "thus far invincible aggressiveness of the Soviet Union," he stated, "we have to accept Big Government for the duration—for neither an offensive nor a defensive war can be waged...except through the instrument of a totalitarian bureaucracy within our shores."[16] He also wrote, "Where reconciliation of an individual's and the government's interests cannot be achieved, the interests of the government shall be given exclusive consideration" (quoted in Rothbard 1964, 230). One of his collaborators, James Burnham, lamented that Americans seemed reluctant "to accept the responsibilities of empire" and showed no "willingness to kill people, now and then, without collapsing into a paroxysm of guilt" (Burnham 1971, 749).

15. Taft was commenting in the *Nation* (13 December 1941) on an article by Arthur Schlesinger, Jr., that had appeared in the magazine a week earlier, in which the historian claimed that American business favored appeasing Hitler. See J. Martin 1964, 1278.

16. Buckley 1952. Observe the difference between this and William Henry Chamberlin's version: "In any conflict between the individual and the state...my sympathies are always instinctively with the individual" (1940, 299). After World War II, Chamberlin apparently came around to Buckley's position.

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Compare such statements to this 1957 statement written by Old Rightist Felix Morley, a founding editor of *Human Events:*

> We are trying to make a federal republic do an imperial job....To make our policies conform to our institutions is to revert to isolationism. It would mean the termination of our alliances; withdrawal of all troops to our own shores; reduction of military expenditure to a truly defensive level; complete indifference to political developments abroad, regardless of whether these help or hinder the advance of Communism. (26)

Or this from Frank Chodorov:

> If we will, we can still save ourselves from the cost of empire building. We have only to square off against this propaganda, and to supplement rationality with a determination that, come what may, we will not lend ourselves, as individuals, to this new outrage against human dignity....We will resist, by counterpropaganda, every attempt to lead us to madness. Above all, when the time comes, we will refuse to fight, choosing the self-respect of the prison camp to the ignominy of the battlefield. ([1947] 1980, 344)

There is no gainsaying that the Buckley right was indeed a New Right.[17]

The disagreement between Old and New Right over the Cold War is more than a clash of empirical assessments of a Soviet threat. It runs deeper. The remnant of the Old Right that remained to fight against the Cold War was radically antiwar and antimilitarist in the conviction, as we shall see, that waging the Cold War would bring to America precisely that which the Cold Warriors claimed to oppose. Where some Old Rightists occasionally sounded like Cold Warriors, the cause was their exasperation with the New Deal and Fair Deal "liberals," whom they had reason to despise. When the Old Right isolationists spoke out against entry into World War II, arguing that participation would, among other things, aid the spread of Soviet communism, they were smeared as "Vichy Fascists," "Nazi fellow travellers," and anti-Semites; harassed by government agents; and in some cases even prosecuted for sedition (Rothbard 1978, 87–89; see also Doenecke 1982, 212, and Steele, 1979). Later, to their horror, they witnessed Stalin's forces rolling to the Elbe and cringed at Roosevelt's obeisance toward "Uncle Joe" and the inevitable codification of Soviet gains at Yalta and Potsdam. They also witnessed the communist exploitation of the upheaval the war caused in China. All of this produced an understandable attitude of "we told you so"

17. For an expression of concern that the New Right's *social* policies were collectivist, see Frank Meyer (1955), in which Meyer, the "fusionist," accuses Russell Kirk of being "at the best equivocal" (559) on the relationship of the individual and society. He also argues that conservatism "carried with it, however, no built-in defense against the acceptance, grudging though it may be, of institutions which reason and prudence would otherwise reject, if only those institutions are sufficiently firmly established" (559).

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toward the liberals. They missed few opportunities to throw the postwar communist gains in the liberals' faces.

To be sure, a few Old Rightists slipped into unabashed boosterism for America's Third Crusade (Nash 1976, 126–27). Rothbard (1968b), in studying the issue, employs the useful distinction between broad and narrow revisionism. He writes:

> The narrow Revisionists, who form, unfortunately, the large majority, have reasoned somewhat as follows: The chief lesson of World War I is the injustice heaped upon Germany—first, in launching the war against her, and then in coercing a confession of sole guilt in the brutal and disastrous Treaty of Versailles. The same focus on an injured Germany then blends into the analysis of World War II, caused essentially by continually repeated obstructions by the Allies of any peaceful revision of a *Versaillesdiktat* which they themselves admitted to be gravely unjust to Germany.
>
> What lesson, then, does the narrow Revisionist draw for the postwar period? Since his concentration is narrowly upon the wrongs suffered by Germany, his conclusion then follows that these wrongs must be put right as quickly as possible; which, in the current context, becomes a compulsory unification of West and East (or for the Revisionist, Middle) Germany, on Western terms, and a return of the lands beyond the Oder-Neisse from Poland. In short, the narrow Revisionist ends, ironically, by yearning for the very sort of unilateral *diktat* and blind *revanche* which he so properly deplored when Germany suffered from their evils. Finally, in his current preoccupation with World War II and the German problem, the narrow Revisionist carries over the old anti-Comintern spirit, or what is now called "hard anti-Communism," into an entirely different era....The narrow Revisionist...has gotten himself enmeshed in a veritable tangle of contradictions. Beginning in dedication to peace, he has become a virtual advocate of total war (against the Soviet Union). (1968b, 316)

To the broad Revisionist, Rothbard continues,

> peaceful revision and peaceful negotiation are not ideas solely applicable to Germany [but] are applicable to all times and places, and therefore to the postwar world as well....To the broad Revisionist the great lesson of the two World Wars is precisely to avoid as a very plague any further Great Crusade, and to maintain—if we value the lives and liberties of the American people—a steadfast policy of peaceful coexistence and abstinence from foreign meddling....[I]t is a conclusion in almost diametric opposition to the views of his old narrow-Revisionist colleague. (1968b, 318–19)

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Inconsistencies by particular Old Rightists can be found, but they do not invalidate the distinction between old and new. A few Old Right figures, for example, at times inclined toward some aggressive anticommunist or anti-Soviet policies. But they did so with a sense of skepticism and misgiving, a position different from adopting wholeheartedly the New Right's Cold War temperament. This temperament denotes not merely an abhorrence of the doctrines of Marx and Lenin or distress for the victims of Soviet tyranny or concern about communists in the government, all of which the Old Right shared; it also means support for a commitment and readiness by the U.S. government to contain, wear down, and in many cases roll back Soviet forces. Its salient feature is its jihad character, the sense that it is the glorious destiny of the United States, leader of the Free World, to destroy Godless Communism.

Although the New Right was built predominantly by figures not associated with the Old Right, some Old Rightists broke ranks after World War II. The historian William Henry Chamberlin, who changed from communist sympathizer to right-wing war foe in 1940 to advocate of anti-Soviet activism and red-baiter of Old Rightists in 1945, and John Chamberlain, critic, editor, and economics writer, who followed a similar trajectory, both adopted the Buckley group's foreign policy.[18] Similarly, Senator Arthur Vandenberg, an opponent of U.S. participation in World War II, pirouetted into an establishment booster of the Cold War and bipartisan foreign policy.

Only by recognizing the distinctiveness of the Old Right, especially in its analysis of foreign policy, can one acquire an accurate picture of American political history and the rise of an overtly libertarian movement in the late twentieth century.

Professionally, the Old Right consisted of members of Congress, other politicians, writers, and businessmen. Many were veterans of the fight against Prohibition and in some cases members of the anti-Roosevelt American Liberty League.[19] What ultimately united these individuals was the determination to resist the swallowing up of American ideals, institutions, and traditions by the monster of collectivism, which in different forms they saw settled or settling in Moscow, Rome, and Berlin and threatening to settle in Washington. Key Old Right figures will be discussed in two groups: politicians and publicists.

18. See William Henry Chamberlin's *America's Second Crusade* (1950) for his views on the disaster of World War II. In 1940 he called himself an advocate of "mild anarchism," or "anarchy plus a police constable": "a state strong enough to maintain internal order, but not strong enough to carry on wars...and perform the other devilries to which a strong state is prone" (1940, 300). See also John Chamberlain's *A Life with the Printed Word* (1982).

19. For a revisionist and critical look at the League, see my article "A Matter of Degree, Not Principle: The Founding of the American Liberty League" (1982).

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The Politicians

Beginning in the mid-1930s a group of U.S. Senators and Representatives coalesced in opposition to the policies of Franklin Roosevelt. It was a diverse group, including some who were uneasy with Roosevelt from the start, even if they had voted with him, and some who, despairing over the Great Depression, at first had hopes that the New Deal would work. Those to be discussed were critical of Roosevelt in both foreign and domestic policy. Congressmen who opposed him in one realm only do not seem to qualify as Old Rightists. Several conservative Democrats, for example, including Senators Carter Glass of Virginia, Thomas P. Gore of Oklahoma, and Harry Byrd of Virginia, despised Roosevelt's domestic policies from the start, but supported his pro-war measures (see Patterson 1967, 19–31, 337). In contrast, the progressive Republican Senator Robert La Follette, Jr., of Wisconsin opposed the war measures while pushing for domestic policies even more interventionist than Roosevelt's.

The congressional foes of the domestic and foreign New Deal included a small number of conservative, or "Cleveland," Democrats, such as Bennett Champ Clark of Missouri, Patrick McCarran of Nevada, and David I. Walsh of Massachusetts (Patterson 1967, 337). The western and midwestern progressive-isolationist Republicans made up another group of congressional opponents of the New Deal, foreign and domestic. Some of them were politicians who won their first political medals in the 1920s and saw themselves as in the tradition of Theodore Roosevelt and Woodrow Wilson.[20] This bloc included William Borah of Idaho, Hiram Johnson of California, Gerald Nye of North Dakota, Henrik Shipstead of Minnesota, and several others. It is useful to consider with this group their ideological brother Senator Burton K. Wheeler of Montana, although he was a Democrat. These men began as sympathetic to the New Deal. The depression and what they regarded as Hoover's half-hearted response to it distressed the Republican progressives, and in the 1932 election they either supported Roosevelt (Hiram Johnson, for example) or were neutral (William Borah and Gerald Nye) because they could not bring themselves to bless Hoover (Feinman 1981, 20). (Roosevelt ran a campaign of contradictions, promising both to cut federal spending by 25 percent and to increase aid to the unemployed, that is, to reduce and increase federal power [Leuchtenburg 1963, 10–11].) In the famous first hundred days the progressive bloc was part of the "tractable Congress" (Patterson's term) that gave Roosevelt what he wanted. But the bloc was not firmly in his pocket. Its growing dislike of the New Deal "represented an older hostility to centralized power, be it corporate or governmental" (Patterson 1967, 116). The aversion to power sprang from its fundamental individualism (Graham 1967, 176).

20. Otis Graham counts sixty old progressives who opposed the New Deal. See his *An Encore for Reform: The Old Progressives and the New Deal* (1967); the list of names is on pages 192–93.

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The earliest fight with Roosevelt that has the markings of the inchoate Old Right's participation was, aptly, in foreign affairs, when the isolationists in 1935 defeated Roosevelt's proposal to have the United States join the World Court (Leuchtenburg 1963, 216–17). Other early conflicts with Roosevelt had to do with neutrality, as auguries of war arose in Europe. Here the essential constitutional issue emerged starkly. Throughout the neutrality fights of 1935, 1936, and 1937, the point of battle was executive discretion, with the isolationists trying to deprive Roosevelt of room to maneuver and the president trying to maximize his flexibility.

The event that arguably catalyzed the emergence of a full-fledged Old Right was Roosevelt's attempt to pack the Supreme Court. During the early New Deal, the U.S. Supreme Court was the one bulwark that kept Roosevelt from carrying out all his plans. In 1935 and 1936, respectively, the pillars of the New Deal—the National Industrial Recovery Act and the Agricultural Adjustment Act—dropped like trees giving way to the logger's blade.[21] It was a shocking blow to FDR and the zealous New Dealers. The progressives had been uneasy with these programs from the beginning. Although they tended to support Roosevelt's relief measures, they disliked the direction of the NIRA and AAA. In the fall of 1934, Borah wrote to a constituent:

> I feel very strongly that the situation in this country is critical in more ways than one. It is critical economically and governmentally.... If I am not mistaken, the trend in some aspects is absolutely at war with the fundamental principles of American institutions, and will ultimately undermine many of the rights of the citizen. (Feinman 1981, 78)

Borah, Nye, Wheeler, and others distrusted programs such as the NIRA that handed extraordinary power to businessmen. They despised the government-enforced codes and price-fixing and the suspension of the antitrust laws. They equally abhorred the AAA's crop destruction and other controls. Some observers thought it odd that those veteran progressives objected to Roosevelt's first measures, but their objections to the programs were entirely consistent with their stated philosophy. As progressives, they distrusted the concentration of power, which is what they saw in the early New Deal.

> Their first and most frequent complaint was that the New Deal was unforgivably coercive, and far from entering upon that role with hesitation, apologies, and promises of early retrenchment, it gave all signs of a permanent Federal paternalism. Without question it was NRA that most embodied this trend toward statism (with AAA corroborating evidence), but even after the death of NRA these

21. The court also struck down the Guffey Coal Conservation Act as unconstitutional and nullified New York State's minimum wage law.

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> progressives perceived signs enough that the New Deal could be summed up as a drive toward a permanent collectivism. (Graham 1967, 66–67)

They had been sympathetic to government activism earlier in the century, but things had changed.

> The writings of the progressives are strewn with worried references to Mussolini and Hitler and Stalin, to the emergence of malignant totalitarian regimes. The progressive American, never entirely at home with the state because he was an American before he was a progressive, saw in Europe's conversion to totalitarianism a case of history teaching by negative example that those who proposed to grant further power to government in the cause of social reform were headed in the wrong direction. Reformers, apparently, had overestimated the amiability of government—that was the lesson of 1917 in Europe, and of 1922, and of 1933. (Graham 1967, 48)

If they had doubts about Roosevelt's direction before the Supreme Court acted, those doubts were reinforced with steel rods by his official response to the decisions. On February 5, 1937, Roosevelt asked Congress to restructure the court so that whenever a justice who had held his position for ten years or more waited longer than six months to retire after his seventieth birthday, the president could name an additional justice to the bench. Roosevelt justified this bill (not a constitutional amendment) on grounds that the court was overworked and inefficient because of the advanced age of many of the justices. Six of the nine members were over seventy, so under the proposed plan Roosevelt could name six additional justices.

The rationalization was transparent, as Roosevelt's adversaries hastened to point out, and the opposition quickly congealed (Leuchtenburg 1963, 233). The leader of the Senate opposition was the Democrat Burton K. Wheeler. He wrote to the socialist Norman Thomas, "It is an easy step from the control of a subservient Congress and the control of the Supreme Court to a modern democracy of a Hitler or a Mussolini" (Ekirch [1955] 1969, 199). And a future Republican senator who was yet to have his season also denounced the plan. "If the present attempt succeeds," said Robert A. Taft of Ohio, "it will practically mean an end of the Constitution and of judicial independence" (Cole 1983, 217). On July 22, 1937, the proposal was interred permanently in the Senate Judiciary Committee. Its demise elicited a "Glory be to God!" from Senator Johnson.[22]

Thwarted on the domestic front, Roosevelt turned to foreign affairs. On October 5, 1937, he went to Chicago to dedicate the Outer Link Bridge, which was funded by the Public Works Administration. With the Sino-

22. Cole 1983, 219. Roosevelt had no more luck with his attempt to get authority to reorganize the executive branch. His initial proposal passed the Senate in modified form, but was buried in a House committee (221).

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Japanese war raging, he used the occasion to speak on foreign policy. He called for peace-loving states to cooperate against the war makers, using the analogy of the need to quarantine the contagiously ill (Cole 1983, 244–45).

Most of the isolationists in the Senate were livid; some threatened impeachment (Leuchtenburg 1963, 226). Borah predicted that if Japanese goods were boycotted, the United States would be "fooling with dynamite" (Cole 1983, 246). Shortly after Roosevelt's speech, Borah wrote:

> But this running around over the world trying to placate every situation and adjust every controversy is not the business of a democracy. A democracy must live at home or have no life. Totalitarian states which have absolute control over their subjects and may send them into any way that personal discretion or ambition suggests may engage in combat against aggressors, and so forth, but democracies cannot do so.[23]

Johnson syllogized, "The levying of sanctions means their enforcement and their enforcement means the Navy's activity. At once then you have war." He remarked that "the President with his delusions of grandeur sees himself the savior of mankind," and he went on to charge that Roosevelt was trying to take the public mind's off domestic woes (Cole 1983, 246–47). The fear that Roosevelt wished to intervene against Japan made the anti-interventionists suspicious of the naval appropriations bill that was before Congress.

The isolationists were so distrustful of Roosevelt that Johnson didn't want the Senate to adjourn for fear that the president would get involved in war. "We must be on guard...," Johnson said on the Senate floor, "every minute of the day and every minute of the night in the days to come, to see that we shall not participate in a war which is none of our concern" (Feinman 1981, 180).

When Germany invaded Poland in September 1939, the isolationists resisted against all odds Roosevelt's attempt to change the neutrality laws. Borah and Johnson were unalterably against ending the arms embargo. In his last speech before his death in January 1940, Borah marshaled his legendary oratorical skills to indict the "war hounds of Europe" and to condemn the war as "nothing more than another chapter in the bloody volume of European power politics." In a moving scene, the Senate gallery burst into applause and fellow Senators congratulated him (Feinman 1981, 184).

Lend-Lease also attracted dispute: the fiery Johnson referred to it as "the New Deal's triple 'A' foreign policy" and alleged that it would "plough under every fourth American boy."[24] The prospects of an alliance with the

23. Feinman 1981, 170. Yet Borah was not totally against the president regarding the speech. See Maddox 1969, 232–33.

24. Cole 1983, 415. Roosevelt said his remark was "the rottenest thing that has ever been said in public life in my generation."

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Soviet Union upset Clark: "Once we have crawled into bed with 'Bloody Joe' no restraints are possible on the spread of Communist propaganda in this country" (*America First Bulletin* 1941, 1).

Senator Robert Taft, elected in 1938, zeroed in on Roosevelt's apparent disregard of democracy:

> One day the President sends American troops to Iceland in the war zone. The next day he refuses to submit to Congress the question whether troops should be sent to foreign lands. That is not democracy. The occupation of Iceland indicates a deliberate policy to involve the United States in war without Congressional action.... If the occupation of Iceland is defense, then any act the President cares to order is defense. (Stout 1942, 176)

Taft also feared that U.S. involvement in the war would lead to American imperialism. The war advocates, he said, "seem to contemplate an Anglo-American alliance perpetually ruling the world.... Such imperialism is wholly foreign to our ideas of democracy and freedom" (Patterson 1972, 245).

But the moving oratory could not stop the Roosevelt juggernaut. Congress proceeded to enact what the president wanted: neutrality revision, conscription, loans to Britain, extension of the draft, two lend-lease bills, and other laws to facilitate American involvement in the war.

Still the isolationists did not give up. The Old Right members of Congress carried their activities beyond the Capitol. Some of them, for instance, got involved in the America First Committee, which was formed in the fall of 1940 after the destroyers-for-bases deal.[25] Senators who were either members of or advisers to the committee included Nye, Wheeler, Johnson, Shipstead, and Arthur Capper of Kansas (Feinman 1981, 190).

With the Japanese attack on Pearl Harbor and the U.S. declaration of war, the fighting in Congress was essentially over. But within the Republican Party, the battle between isolationists and internationalists was just beginning. At a National Republican Committee meeting in April 1942, Taft opposed a resolution by Wendell Willkie that Taft thought sounded like a repudiation of the Republican congressional isolationists. He presciently feared they were "heading for a direct fight for control of the Party machinery" and that "it would be fatal to the future of the Party if Willkie, [Henry] Luce and Dorothy Thompson, together with the wealthy crowd in the east, succeed in their aim." He said Willkie was wrong to think that the Republican path to victory lay in "being more warlike than Roosevelt" (Cole 1983, 519).

At this point we must broaden the political inquiry to look beyond Congress. The two figures to be briefly discussed are Herbert Hoover and Charles A. Lindbergh, Jr.

25. For the America First story and a collection of its documents, see Doenecke 1990.

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Hoover, as Joan Hoff Wilson has dubbed him, is the "Forgotten Progressive," neither an advocate of laissez faire nor a conservative in the New Right sense.[26] Despite inconsistencies after World War II, especially regarding Asia, he was a committed noninterventionist. His overriding conviction was that war leads to economic upheaval, which, in turn, leads to revolution and the self-styled savior who promises to right everything if he is given all power. The resulting totalitarian doctrines and social experiments doom the otherwise natural and peaceful evolution toward individual liberty. His view had a great influence on several Old Right publicists. In 1922 he wrote about the aftermath of the Great War:

> We have witnessed in the last eight years the spread of revolution over one-third of the world. The causes of these explosions lie at far greater depths than the failure of governments in war. The war itself in its last stages was a conflict of social philosophies—but beyond this the causes of social explosion lay in the great inequalities and injustices of centuries flogged beyond endurance by the conflict and freed from restraint by the destruction of war. (1)

Hoover came to oppose intervention because, as he had told Woodrow Wilson,

> we should probably be involved in years of police duty, and our first act would probably, in the nature of things, make us a party to establishing the reactionary classes in their economic domination over the other classes. This is against our fundamental national spirit and I doubt whether our soldiers under these circumstances could resist infection with Bolshevik ideas. (Wilson 1975, 54–55)

He disliked Roosevelt's "quarantine" speech and approved the Munich settlement (Wilson 1975, 239). Although he later supported aid to England short of American troops, he opposed active U.S. participation in the war (against either Russia or Germany) and suspected that Roosevelt was intent on entry. He referred to FDR's "fireside chats" as "fire-provoking chats" (247). He also feared that the president's pressure on Japan was strengthening the regime there and that it would lead to war. When Germany attacked the Soviet Union, Hoover expected Hitler to defeat Stalin and make peace with England (247–48). When Japan attacked Pearl Harbor Hoover did not dissent in public, but privately he looked forward to an investigation. He wrote in several letters on December 8, 1941, "You and I

26. See Hoover's own book *The Challenge to Liberty* [1934] (1971). See also the important revisionist work on Hoover as architect of the first New Deal by Rothbard: "Herbert Clark Hoover: A Reconsideration" (1966) and "Herbert Hoover and the Myth of Laissez Faire" (1972b, 111–45).

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know that this continuous putting pins in rattlesnakes finally got this country bitten."[27]

During the early stages of the Cold War, Hoover refused to appear before the House Un-American Activities Committee and to become chairman of President Truman's commission "to report on the question of infiltration of Communists in Government." According to Joan Hoff Wilson (1975), "Hoover's anticommunism was so nonmilitaristic that he was later called 'a tool of the Kremlin' by Cold Warriors during the Truman and Eisenhower administrations of the early 1950s" (237).

He generally opposed coercion both at home and abroad in the fight against communism. In a 1941 radio broadcast, he said "we cannot slay an idea or an ideology with machine guns. Ideas live until they have proved themselves right or wrong" (Wilson 1975, 238). He was critical of the Korean War, presuming that the "Reds just want to bleed us to death with these small-scale wars," though he had approved the Truman Doctrine and its aid to Greece and Turkey (Wilson 1975, 265). In the end he expressed a position that compromised: in place of the containment doctrine, strong air and naval protection of the Western Hemisphere and "watchful waiting before we take on any commitments." He predicted that the "evils of communism...will bring their own disintegration"—one of the Old Right's several correct predictions.[28]

Lindbergh was an American hero, a dashing aviator, an America First national-committee member and its most popular spokesman, and someone with as much charisma as Franklin Roosevelt (see Cole [1953] 1971, 1974). His work in rallying public opposition to entry into World War II was instrumental in keeping the pressure on the president and Congress for as long as it lasted. Smeared as a fascist and anti-Semite, he and his wife, Anne Morrow Lindbergh, persevered energetically only to see their efforts blown apart along with the ships at Pearl Harbor.

In his "A Letter to Americans" (1941) Lindbergh blamed the war on England and France's refusal "to take part in a European readjustment while there was still time to make it peacefully" (63–81). "Adjustments that should have been made in peace and moderation," he wrote, "were finally brought by war and resulted in immoderation" (Schoonmaker and Reid 1941, 63–64). Having failed to remove the seeds of future hostilities, England and France then became complacent and allowed Germany to surpass them in strength. By the time they were willing to fight, they were inferior militarily.

27. Wilson 1975, 248. For a statement by Hoover on entering the war, see "The Immediate Relation of the United States to this War" (1941, 3–12). See also Doenecke 1987.

28. Wilson 1975, 265–66. Hoover was joined in his opposition to the Korean War by Joseph P. Kennedy, former ambassador to Great Britain. An opponent of U.S. participation in World War II, Kennedy also wanted to keep America out of the Cold War. In late 1950 he called for U.S. withdrawal from Korea and West Germany. "What business is it of ours," he asked, "to support the French colonial policy in Indo-China or to achieve Mr. Syngman Rhee's concepts of democracy in Korea?" (*Vital Speeches* 1951, 170–73).

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The United States found itself in a similar situation. While the German-Russian alliance was still in force, Lindbergh wrote:

> We, in America, are being led to war by a group of interventionists, and foreign interests, against the will of a majority of our people. Every poll of public opinion has shown that from 80 to 95 per cent of Americans are opposed to entering this war. Both the Republican and Democratic parties were forced to incorporate antiwar planks in their platforms. Both presidential candidates were compelled to take a stand against our intervention. Yet, today, although no one has made an attempt to attack us, we already have one foot in the war. (Schoonmaker and Reid 1941, 69)

He forcefully rejected, as "entirely out of the question," the argument that Germany could invade the United States by air (78).

Lindbergh closed the letter with a call to the American people to write their senators, representatives, and local newspapers:

> We should not be conscripting our youth for a foreign war they do not wish to fight.... If our American ideals are to survive, it will not be through the narcotic of foreign war, but through a reawakening of the spirit that brought this nation into existence.[29]

With U.S. entry into the war a fait accompli, Taft took center stage for the Old Right. He did so more because of his station and prestige than because of the purity of his stand; for though many of his colleagues were more consistent in battling U.S. globalism after World War II, Taft's eminence made him the rallying point for the Opposition and for its hopes of capturing the White House.

Despite his policy lapses, Taft earned his place as the leader of the Opposition because of his core belief in limited government and individual liberty and his skepticism that America's proper role in the world was that of policeman or proconsul. He had no illusions about an American mission to bring democracy to the world at the point of a bayonet or in the radioactive plume of a mushroom cloud. For him foreign policy had but one objective: the security of the lives and property of the American people. As he prepared his bid for the Republican presidential nomination, he wrote in his 1951 book, *A Foreign Policy for Americans*:

> There are a good many Americans who talk about an American century in which America will dominate the world. They rightly point out that the United States is so powerful today that we

29. Schoonmaker and Reid 1941, 79, 81. Lindbergh was later accused of anti-Semitism when he named the Jews as one of three groups, along with the British and the Roosevelt administration, pushing for entry into the war. However, many people who knew Lindbergh, including a former president of B'nai B'rith, said Lindbergh was not an anti-Semite (Cole 1974, 171ff.)

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> should assume a moral leadership in the world to solve all the troubles of mankind. I agree that we need that moral leadership not only abroad but also at home. We can take the moral leadership in trying to improve the international organization for peace....
>
> If we confine our activities to the field of moral leadership we shall be successful if our philosophy is sound and appeals to the people of the world. The trouble with those who advocate this policy is that they really do not confine themselves to moral leadership. They are inspired with the same kind of New Deal planned-control ideas abroad as recent Administrations have desired to endorse at home. In their hearts they want to force on these foreign peoples through the use of American money and even, perhaps, American arms the policies which moral leadership is able to advance only through the sound strength of its principles and the force of its persuasion. I do not think this moral leadership ideal justifies our engaging in any preventive war, or going to the defense of one country against another, or getting ourselves into a vulnerable fiscal and economic position at home which may invite war. I do not believe any policy which has behind it the threat of military force is justified as part of the basic foreign policy of the United States except to defend the liberty of our own people. (17–18)

Perhaps Taft's greatest contribution was his attempt to force a public debate on postwar foreign policy. In the sliver of time between the close of the world war and the opening of the Cold War, the policymakers had put together a bipartisan coalition in support of American globalism. The dash toward bipartisan foreign policy might have squelched all debate had it not been for Taft's public dissent. He would have endorsed the remark of Felix Morley, a founding editor of *Human Events*: "Politics can stop at the water's edge only when policies stop at the water's edge. Policies no longer stop there" (1948, 4).

Early on, Taft expressed skepticism at President Truman's foreign policy and its official rationale. In 1947, when Truman promulgated his Truman Doctrine and asked for military aid to Greece and Turkey, Taft struck at the president's "policy to divide the world into zones of political influence, Communist and non-Communist" (quoted in Liggio [1965] 1978, 24). He feared that Truman had imperial aims and that the Russians would be provoked into war "just as we might go to war if Russia tried to force a communist government on Cuba" (quoted in Stromberg 1971a, 11; see also Berger 1967, 129). But Taft finally voted for the aid, after concluding that war would not ensue, because Truman had virtually made a commitment and "to repudiate it now would destroy his prestige in the negotiations with the Russian Government" (Berger 1967, 130). Taft's vote demonstrates

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Randolph Bourne's point that so-called democratic checks on executive war-making power are largely chimerical.[30]

In the same year, when Secretary of State Gen. George Marshall proposed the vast foreign-aid program for Europe, Taft was "absolutely opposed," arguing it would furnish anti-imperialist arguments for the communists. But, again, he ultimately voted with the administration, after unsuccessfully trying to amend the law, because of America's tradition of charity and because he believed the program would assist in the ideological battle against communism. However, he thought the premise of the program was that the Russians did not plan on war (Berger 1967, 132).

He did not regard the Soviet occupation of eastern Europe, accomplished during the rolling back of an invading force, a portent of aggression. The conflict with the Soviet Union, he said, was ideological, not military, and he maintained he had "not believed that Russia intends or desires conquest by force of arms of additional territory" (Liggio [1965] 1978, 29). When the administration tried to exploit the Czech coup in March 1948 for its own purposes, Taft responded:

> I do not quite understand the statements made yesterday by Secretary Marshall and President Truman. They do not imply that they believe that we do face a war question; and then they seem to use the concern which is aroused to urge the passage of this particular program [the Marshall Plan]. I do not believe that the two are connected.... I believe that the tone of the President's statement that his confidence in ultimate world peace has been shaken is unfortunate. Certainly it is no argument for the passage of the current bill.... But let me say that I myself know of no particular indication of Russian intentions to undertake military aggression beyond the sphere of influence which was originally assigned to the Russians. The situation in Czechoslovakia is indeed a tragic one; but the Russian influence has been predominant in Czechoslovakia since the end of the war. The Communists are merely consolidating their position in Czechoslovakia; but there has been no military aggression, since the end of the war. (Liggio [1965] 1978, 30–31, quoting *Cong. Rec.*, 80th Cong., 2d sess., 2643–44)

The shiniest, fattest rhinestone in Truman's Cold War costume jewelry was the North Atlantic Treaty Organization, which he proposed after the

30. See Randolph S. Bourne 1964, 83. Bourne writes: "The formality by which Parliaments and Congresses declare war is the merest technicality. Before such a declaration can take place, the country will have been brought to the very brink of war by the foreign policy of the Executive. A long series of steps on the downward path, each one more fatally committing the unsuspecting country to a warlike course of action will have been taken without either the people or its representatives being consulted or expressing its feeling. When the declaration of war is finally demanded by the Executive, the Parliament or Congress could not refuse it without reversing the course of history, without repudiating what has been representing itself in the eyes of the other States as the symbol and interpreter of the nation's will and animus."

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Czech coup and the Berlin blockade. Taft led the opposition. "I cannot vote for a treaty which, in my opinion, will do far more to bring about a third world war than it will ever to maintain the peace of the world," he said (quoted in Liggio [1965] 1978, 33). Taft particularly objected to the obligation of the United States to arm western Europe, which he found provocative, and to the U.S. commitment to go to war if any of the members is attacked—even if the attack is justified or launched by another member. In other words, Taft did not like putting the United States, as he described it, "at the mercy of the foreign policies of 11 other nations" (Stromberg 1971a, 14). He also thought the treaty violated the purpose of the United Nations by dividing the world into "two armed camps" (16).

Taft's alternative was not "isolationism," but rather the extension of the Monroe Doctrine to western Europe. In other words, if the Soviet Union attacks western Europe, "it will be at war with us" (Stromberg 1971a, 14).

Taft's policy did not carry the day, and he voted against the North Atlantic Treaty. This vote stands out because in his ambivalence, either genuine or politically motivated, Taft cast other votes that contradicted the spirit of the Old Right. Despite his opposition to universal military training, for example, he voted for conscription three times, in 1948, 1950, and 1951. (He had opposed it in 1940 and 1941.)[31]

When Truman sent troops to Korea, Taft initially confined his objections to the constitutional: "If the president can intervene in Korea without congressional approval, he can go to war in Malaya or Indonesia or Iran or South America" (Stromberg 1971a, 18). Otherwise he supported vigorous prosecution of the war. He criticized the Truman administration for inviting the attack by announcing that Korea was not important to U.S. defense strategy. He said further that the difficult position the United States found itself in after Communist China entered the war resulted from the administration's decision to give Nationalist China on Formosa "one hundred per cent support." Departing from Hoover and Joseph P. Kennedy, however, he opposed withdrawal from Korea (Taft 1951, 107–9), and he supported air strikes on Manchuria and South China even at the risk of bringing Russia into the war (Berger 1967, 135).

Yet these actions do not fully convey Taft's position. He told reporters in 1951 that had he been president, he would not have sent troops to Korea. He also said he would "fall back to a defensible position in Japan and Formosa" (Patterson 1972, 485). Later he seemed willing to make a truce on the basis of the thirty-eighth parallel (489, 601). This position, along with that of Hoover and Kennedy, provoked the *New Republic* to denounce the Old Right as "the Stalinist caucus" (Liggio [1965] 1978, 39).

Despite Taft's tergiversation, he was seen as the best bet to challenge the Republican eastern establishment for the presidential nomination in

31. Patterson 1972, 393. As a young man, in 1917, he had supported universal military training (70).

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1952. Among other distinctions, he opposed Truman's seizure of the steel mills in April 1952 as an unconstitutional exercise of power. The establishment, uncomfortable with the man from Ohio who wished to cut foreign aid and have Europe pay more for its own defense, was able to win the nomination for political newcomer Dwight Eisenhower. Among the delegates voting against Taft were Richard Nixon and Barry Goldwater.

In his May 1953 final statement on foreign policy, Taft reiterated his strongest noninterventionist points, focusing especially on Indochina (Liggio [1965] 1978, 44). Taft died in July 1953, but his supporters in Eisenhower's cabinet apparently persuaded the president to resist calls for sending American soldiers, naval forces, and bombers to aid the French colonialists (45).

Other Old Right congressional figures possessed the resolve Taft at times seemed to lack. For example, George Bender of Ohio, a representative and later Taft's successor in the Senate, denounced the Truman doctrine as imperialistic:

> I believe that the White House program is a reaffirmation of the nineteenth century belief in power politics. It is a refinement of the policy first adopted after the Treaty of Versailles in 1919 designed to encircle Russia and establish a "Cordon Sanitaire" around the Soviet Union. It is a program which points to a new policy of interventionism in Europe as a corollary to our Monroe Doctrine in South America. (Liggio [1965] 1978, 24–25, quoting *Cong. Rec.*, 80th Cong., 2d sess., 2831–32)

Perhaps the firmest of all congressional Old Rightists was Howard Buffett, representative from Nebraska (1947–53) and father of investment guru Warren Buffett, chairman of Berkshire Hathaway, Inc. Howard Buffett was Taft's midwest campaign manager in 1952 and a self-conscious member of the fledgling libertarian movement.[32] What he opposed most of all was imperialism and its chief requirement, conscription. In 1944, in a speech against U.S. government funding of an Arabian oil pipeline, Buffett blasted the project as a "gigantic long-distance venture into imperialism." He added, "to defend this far-away imperialistic economic venture a volunteer army large enough could not be raised" (Stromberg 1971b, 2).

Buffett was among the earliest of Cold War opponents and as a result was red-baited by a colleague. In battling the Truman Doctrine, he prophesied that "all over the world we would soon be answering alarms like an international fireman, maintaining garrisons, and pouring out our resources." He continued: "Even if it were desirable, America is not strong

32. Buffett wrote articles for *Human Events*, the *Freeman*, and *New Individualist Review* on subjects ranging from conscription to inflation, and according to Murray N. Rothbard was influenced by F. A. Harper, founder of the Institute for Humane Studies (IHS). Buffett was a founding board member of IHS.

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enough to police the world by military force. If that attempt is made, the blessings of liberty will be replaced by coercion and tyranny at home" (Stromberg 1971b, 5).

In 1948 he fought the selective-service bill, stating that "This measure would declare to the world that Hitler was right—that the threat of communism externally justified militarism and regimentation at home." He condemned the draft as embodying the "totalitarian concept that the state owns the individual" (Stromberg 1971b, 7). And when the Korean War came along, Buffett refused to be stampeded into support, as so many on the Left and Right were. Murray Rothbard (1968a) reported:

> Howard Buffett was convinced that the United States was largely responsible for the eruption of conflict in Korea; for the rest of his life he tried unsuccessfully to get the Senate Armed Services Committee to declassify the testimony of CIA head Admiral Hillenkoeter, which Buffett told me established American responsibility for the Korean outbreak. (49)

As the mid-1950s approached, the Old Right contingent in Congress dwindled as members died or retired. The last stand concerned the Bricker Amendment, which would have nullified any treaty provision that conflicted with standing law or with a provision of the Constitution. The liberals and the Eisenhower administration opposed it. In February 1954 it died, a metaphor for the Old Right itself.

The Publicists

If the Old Right can be said to have had godfathers, they are H. L. Mencken and Albert Jay Nock. Mencken was born in 1880, Nock in 1870. Both were writers and editors; both were resolute individualists who saw the state as an imposition; both were branded left-wing radicals in the twenties and right-wing conservatives in the thirties. In truth, both were classical liberals, or libertarians. They were longtime good friends who agreed on virtually everything. When it was suggested in 1944 that they engage in correspondence about current issues in order to construct a book, Mencken turned down the project. "The truth is," he wrote in his diary, "that Nock and I are so close in our main ideas that it would be impossible to get up much interest in the correspondence between us. There would be no conflict whatsoever, but only an incessant ratification and acquiescence" (1989, 295). Mencken's taste in books of correspondence was indicated some time earlier, in 1910, when he and Robert Rives La Monte published a debate on socialism. In it Mencken expressed his abhorrence for any system that would interfere with the creative "superior" individual (see Mencken and La Monte 1910).

Throughout his long career as a newspaper man, literary critic, magazine editor, book author, social commentator, scholar, and philologist, the

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life-long Baltimorean always ranked individual liberty at the top of his values. A man as widely read and discussed as Mencken was in the 1920s could hardly have failed to influence many people.[33]

Mencken, the self-styled "extreme libertarian," consistently set himself against those whom he saw as the enemies of liberty: William Jennings Bryan, Theodore Roosevelt, Woodrow Wilson, and A. Mitchell Palmer, to name a few. With unparalleled gusto, he battled Prohibition, censorship, and other manifestations of Puritanism.[34]

Mencken publicly fulminated against World War II until he suspended his relationship with the *Sunpapers* of Baltimore in 1941. He wrote that the British were merely trying to squelch a rival power on the continent. "It is a rational reason," he wrote, "but it is as devoid of moral content as a theorem in algebra or a college yell" (quoted in Jonas 1966, 228). This article was reprinted in the 1941 book *Keeping US Out of War* (edited by Porter Sargent). In 1939 he noted, "Wars are not made by common folk, scratching for livings in the heat of the day; but by demagogues infesting palaces" (quoted in Helfrich 1948, 4). Later, in his diary, he wrote, "War, in this country wipes out all the rules of fair play, even those prevailing among wild animals. Even the dissenters from the prevailing balderdash seek to escape the penalties of dissent by whooping up the official doctrine" (1989, 357).

Mencken of course also hated the domestic New Deal and everything else touched by "Roosevelt II," as he called FDR: "There is, in fact, only one intelligible idea in the whole More Abundant Life rumble-bumble, and that idea is the idea that whatever A earns really belongs to B. A is any honest and industrious man or woman; B is any drone or jackass" (Mencken 1956, 306). When Roosevelt devalued the dollar, Mencken displayed his impeccable libertarian instinct by crying, "robbery!" and threatened to go into court (Forgue [1961] 1981, xviii).

Albert Jay Nock, like Mencken, was a "tory anarchist," that is, an anti-egalitarian individualist advocate of minimal government. Influenced by Thomas Jefferson, Henry George, Herbert Spencer, and Franz Oppenheimer,[35] Nock combined a knowledge of history and sociology to construct a worldview antithetical to the ruling notions of his day. For Nock, as for Oppenheimer, there was an irreconcilable contest between social power, the network of consensual relations and transactions, and state power, the web of coercive impositions; when one gains, the other loses. In the twenties,

33. One person he influenced was Henry Hazlitt, who succeeded Mencken as editor of the *American Mercury*.

34. See Rothbard 1962. As the historian Ralph Raico has pointed out, Mencken inexplicably never credited Bryan for resigning as secretary of state after President Wilson took the nation into World War I.

35. See his *Jefferson* [1926] (New York: Hill and Wang, 1960) and his introduction to Spencer's [1892] *The Man versus the State* (Caldwell, Idaho: The Caxton Printers, 1969); see also Oppenheimer, *The State*, John Gitterman, trans. [1914] (New York: Free Life Editions, 1975).

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when he edited the *Freeman* and published often in Mencken's *American Mercury*, he railed against plutocracy, tariffs, and conformity. As a regular *Mercury* columnist and book author in the 1930s, he attacked the same philosophy, though the targets had a new facade: egalitarian New Dealism.

What he disliked most about the state was that it impoverished the soul. In 1934 he wrote:

> The worst of this ever growing cancer of Statism is its moral effect. The country is rich enough to stand its frightful economic wastage for a long time yet, and still prosper, but it is already so poverty-stricken in its moral resources that the present drain will quickly run them out. I was talking tonight with an old acquaintance in the textile business who said his business had been in the red for eight years, but he had kept it going because he felt responsible for his people and did not like to turn them adrift. "I don't feel that way now," he said. "If the government proposes to tell me how I shall run my business, it can jolly well take the responsibility." That is the frame of mind that Statism inevitably breeds, and a nation that is in that frame of mind is simply no nation at all, as the experience of Rome in the second century shows. (Nock 1948, 11–12)

Although the Democrats won his immediate ire, the clear-eyed Nock had no illusions about the Republicans. He wrote in his journal in 1934:

> Silly talk about whether the New Deal is here to stay. Of course it is here to stay; the only real competition of political parties will be for the privilege and emoluments of administering it. Probably there will be superficial changes, but none essential; none, that is, which will at all redistribute actual power between the State and society. One may safely bet on that. (Nock 1948, 75)

In both eras, whether the *punditi* regarded him a radical or a conservative, he opposed war and American participation in it. He would not be stampeded into supporting the state as protector against the barbarians: "This matter of national defense would take on an entirely different aspect if people could be brought to understand that the only government they need to defend themselves against is their own government, and that the only way to defend themselves against it is by constant distrust and vigilance."[36] The recalcitrant fraction of society Nock sought to address—the "Remnant"—was to be found among the Old Right publicists about to be discussed.

The Old Right publicists tended to cluster around a handful of publications. Their concerns included limited, constitutional government, indi-

36. Quoted in a letter to the editor from Ralph Raico (1954). Nock's definitive statement on politics was his 1935 book *Our Enemy, The State* (1977). That edition contains a highly important introduction on Nock by Walter Grinder. See also Nock's *The State of the Union: Essays on Social Criticism* (1991).

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vidual liberty, the free market (in most cases), the bloated executive (including secret diplomacy), imperialism, colonialism, militarism, war, and in some cases McCarthyism. Before the crusade to get the United States into World War II, some Old Rightists were routinely published in such liberal journals as the *Nation* and the *New Republic*. Later they were barred from them. For example, the old classical liberal Oswald Garrison Villard, former editor and owner of the *Nation*, was forced out as a columnist because of his insistence on strict neutrality.[37] The liberal press also kept out Harry Elmer Barnes.

With venerable journals unavailable, the Old Rightists had little choice but to start new ones. In the 1930s, 1940s, and early 1950s such publications as the *Freeman* (published by the Henry George School, of which Frank Chodorov was director, and not to be confused with Albert Jay Nock's old 1920s magazine), *analysis*, *Human Events*, *Faith and Freedom*, and another magazine called the *Freeman*[38] were home to these writers. Among established publications, Colonel Robert McCormick's *Chicago Tribune* was still a bastion of anti-New Deal and isolationist thinking (see Edwards 1971). In these pages, the holdout opponents of foreign intervention, including the Cold War, made their case, even as the public and some former allies deserted them.

Concern with executive power colored much of what they wrote. In the first "sample" issue of *Human Events* in November 1943, Felix Morley criticized Secretary of State Cordell Hull for stating that the Declaration of Austria, an agreement among the Soviet Union, England, and the Roosevelt administration, had been "proclaimed in the name of 'the government of the United States.'" Morley reminded his readers that although the executives of the Soviet Union and England had virtually unlimited foreign-policy powers, the president of the United States did not. "As a former member of the Senate," wrote Morley, "which body must advise and consent by a two-thirds majority, in the ratification of any treaty, Secretary Hull might well have avoided this slip."[39]

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37. Villard was an early advocate of laissez faire and an opponent of U.S. participation in World War I. Disillusioned with capitalism, he turned toward progressivism in 1919 and later embraced the New Deal and its welfare-state measures. Eventually he became alarmed with the resulting obese executive branch (he disliked the court-packing plan) and its potential for militarism, warning even that fascism loomed. See Wreszin 1965, 208ff. See also Radosh [1975] 1978, 67ff.

38. This *Freeman* was started in 1950 by Henry Hazlitt, John Chamberlain, and Suzanne LaFollette. In 1954 it was bought by Leonard E. Read, who in 1946 had set up the Foundation for Economic Education to promote the "freedom philosophy." When Read bought the magazine, Chodorov became the editor. Before this, Chodorov had edited his own broadsheet, *analysis*, which he merged with *Human Events*, when he became contributing editor.

39. Hanighen and Morley 1945, 3. Morley, with Frank C. Hanighen and William Henry Chamberlin, were the editors of *Human Events*. Morley was a Pulitzer Prize–winning editorial writer for the *Washington Post* in the 1930s and former president of Haverford College. See Morley (1949, 1951, 1959), and his memoir, *For the Record* (1979).

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From the first issue in March 1944, Morley and his colleagues set off an alarm against burgeoning government and permanent military alliances. "True liberalism," they wrote in their statement of policy, "will survive neither subordination to a despotic bureaucracy at home, nor entanglement in any Balance of Power system directed from abroad by those over whom American public opinion has no control" (Hanighen and Morley 1944, x).

During the war they expressed fear that the United States had no plan for the aftermath and that the lofty words of the Atlantic Charter were mere ink ready to be washed away by a sea of big-power politics to the advantage of Stalin and Churchill. Morley and other *Human Events* authors (including the Socialist Party presidential candidate Norman Thomas) communicated their severe reservations about saturation bombing of Germany and Japan as well as about the United Nations with its big-power veto. They protested the dropping of atom bombs on Japan, the victor's justice of the Nuremberg Trials, and the general dehumanization of the German people. They repeatedly lamented the hypocritical disregard of self-determination as reflected in the Yalta agreement.[40]

Morley, in particular, seemed eager to demonstrate how the war was vindicating the earlier isolationists.

> Communism will develop throughout Europe, almost automatically, as an interminable war steadily undermines the economic stability without which representative government collapses and democracy becomes merely an empty word.... Should the net result of our second major crusade in Europe be the communization of that Continent, many Americans will begin to ask whether such outcome is really worth the price we are paying for its accomplishment. (Morley 1944, 156–57)

Morley seemed to be speaking for most Old Rightists.

For years to follow, Morley pounded the rostrum on behalf of limited government. He refused to accept a compromise between the principles of a republic and those of a superpower. In 1957 he wrote,

> World leadership requires centralization of power in the capital of the nation that seeks dominance. It requires an aristocracy—an elite—that can be completely indifferent to the gusts of public opinion. It requires a socialized economy, a docile labor force, and a system of education that focuses on the training of the gifted.... We must either change our Constitution—openly and honestly—to conform with the imperial policies we seek to follow. Or we must modify those policies to conform to the Constitution as it now

40. For an Old Right indictment of the Nuremberg Trials as an exercise in ex post facto law, see Taft 1964, 310–22.

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> stands. The Federal system was not designed to promote world leadership by the United States. (31, 32)

The general subject of America's passage from republic to empire occupied much of the Old Rightists' time. Garet Garrett, the newspaper and magazine writer who since the thirties had warned of the New Deal's distortion of American institutions, in 1952 wrote an eloquent pamphlet on the fateful change. "We have crossed the boundary," he declared, "that lies between Republic and Empire." Roosevelt had brought the welfare state to America, but even he dared not enter a war without asking Congress for a declaration. "Nine years later a much weaker President did."[41]

With great rigor Garrett identified the requisites of empire: executive domination, subordination of domestic policy to foreign policy, "ascendancy of the military mind," a system of satellite nations, and a "complex of vaunting and fear." America had now fulfilled them all, along with a final one: the call of historical necessity.

> It is not only our security we are thinking of—our security in a frame of collective security. Beyond that lies a greater thought.
>
> It is our turn.
>
> Our turn to do what?
>
> Our turn to assume the responsibilities of moral leadership of the world.
>
> Our turn to maintain the balance of power against the forces of evil everywhere...evil in this case being the Russian barbarian.
>
> Our turn to keep the peace of the world.
>
> Our turn to save civilization.
>
> Our turn to serve mankind.
>
> But this is the language of Empire. (Garrett [1953] 1964b,158–59)

Empire was also a preoccupation of Frank Chodorov, a pivotal figure in the Old Right.[42] Greatly influenced by Henry George and Albert Jay Nock, Chodorov was the ideal-type Old Rightist; that is, he was the consummate antistatist. He was heard to say more than once that the ideal government would be small enough to fit in his apartment kitchen. In 1947 Chodorov anticipated Garrett in his article "A Byzantine Empire of the West?," published as the Truman Doctrine was being debated (Chodorov 1980,

41. Garrett [1953] 1964b, 117, 122. For the details of Garrett's life, see Ryant 1989.

42. For a biographical sketch, see Charles H. Hamilton's "Introduction" to Chodorov's *Fugitive Essays: Selected Writings of Frank Chodorov* (1980). Among Chodorov's other writings, see *One is a Crowd: Reflections of an Individualist* (1952) and *Out of Step: The Autobiography of an Individualist* (1962).

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337–49). To the claim that the Russians had to be stopped from rolling over the rest of Europe, Chodorov replied,

> Suppose Russia imposes on the peoples of Europe the slavery conditions prevailing within her borders. Without arguing the point that these conditions have so reduced her own economy that the robbery of subject peoples has become a policy of necessity, we must admit as a matter of experience that slaves are poor producers, and we can predict the collapse of communism in Europe from lack of production. There is the added fact that, unlike the Russians, Western Europe did experience a measure of freedom, the memory of which will engender subversive activity, further slowing up the productive machinery. In short, the slave economy will bring about primitive conditions..., and the vulture state will die from lack of sustenance. It is poor prospect for the next generation of Europeans, to be sure, but is it any worse than another war? Something might survive a spell of communism, while the result of another war, no matter which side wins, will be annihilation. (Chodorov 1980, 346)

Chodorov also warned, on several occasions, that the negative effects of the Roosevelt-Truman foreign policy would not be confined to Europe. "If war comes—and when did imperialism not bring it?—the worst of what we call communism will come with it" (Chodorov 1980, 348).

John T. Flynn, the muckraking investigative journalist, began sounding such warnings before the end of World War II. Flynn, a former progressive and columnist at the *New Republic*, became an early critic of the corporativism of the New Deal (see Flynn 1933). Later he was chairman of the New York chapter of the America First Committee and highly influential on its policies (see Cole [1953] 1971, passim; Stenehjem 1976). At the height of the war, in 1944, he published *As We Go Marching*, in which he traced the rise of fascism in Germany and Italy and described disturbing similarities in the United States. He summed up the similarities in two words: corporativism and militarism. He saw the latter as the driving force of the former. How, he asked, could the federal government expand its power over the economy, and (in its view) avoid depression, without exciting the opposition of the conservative constituencies and the state and local authorities fearful of central encroachment?

> These two stubborn forces...will always force a government like ours to find a project for spending which meets these two conditions: It must be a strictly federal project and it must be one upon which the conservative and taxpaying elements will be willing to see money spent. The one great federal project which meets these requirements is the army and navy for national defense. And this, of course, is quite inadequate unless it is carried on upon a scale which gives it all the characteristics of militarism.... *Thus milita-*

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> *rism is the only great glamorous public-works project upon which a variety of elements in the community can be brought into agreement.* (Flynn [1944] 1973, 207, emphasis added)

He saw the signs in the planning for universal military training, in the nascent alliance system, and in the inchoate imperialism.

> To sum it up...the germs of a vigorous imperialism are here among us—I mean the moral germs.... We have managed to run up a little history of imperial adventure upon a small scale of which we may well be ashamed.... We have managed to accumulate a pretty sizable empire of our own already—far-spreading territories detached from our continental borders.... We have now managed to acquire bases all over the world.... There is no part of the world where trouble can break out where we do not have bases of some sort in which, if we wish to use the pretension, we cannot claim our interests are menaced. Thus menaced, there must remain when the war is over a continuing argument in the hands of the imperialists for a vast naval establishment and a huge army ready to attack anywhere or to resist an attack from all the enemies we shall be obliged to have. Because always the most powerful argument for a huge army maintained for economic reasons is that we have enemies. We must have enemies. They will become an economic necessity for us.[43]

Flynn would not be stampeded by the Cold War into compromising his views. A free America, he declared, could wait out the communists; there will be no war unless the United States starts it. In 1950 radio commentaries he counseled, "the course of wisdom for the American people would be to sit tight and put their faith in the immutable laws of human nature." Thus the United States should "make an end of the cold war."[44]

The "need for an enemy" was a theme picked up by Morley later in books and articles. The economic planners, Morley wrote, were convinced that without massive government spending, the economy would collapse into its prewar state.

> Although economic and political considerations now make it difficult for the Administration to curtail defense spending, it is equally impossible for anyone in authority to admit the fact. No official can openly suggest that the Kremlin may conceivably be sincere in seeking a relaxation of the now completely fantastic armaments

43. Flynn [1944] 1973, 223–25. Flynn was one of the first to foresee America's colonial war in Vietnam. See Radosh [1975] 1978, 253ff., and Doenecke 1979, 238ff.

44. Quoted in Radosh [1975] 1978, 251. Flynn was as unrelenting in his criticism of Franklin Roosevelt as anyone. See Flynn's *Country Squire in the White House* (1940) and *The Roosevelt Myth* (1948).

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> race. One might as well expect the Secretary of the Treasury to say publicly that during an inflationary period Savings Bonds are a bad buy. And because it is in practice impossible for our officials to tell the whole truth they are gradually forced into overt deception. In spite of the cost-of-living indices the steadily depreciating "E" Bonds are advertised as "the safest investment in the world." In spite of the logical and good reasoning often found in Russian overtures it is consistently maintained that because communists are congenital liars, no conciliation of any kind is possible. (Morley 1959, 174–75)

Other Old Rightists also warned that the militaristic policies beginning with Roosevelt had permanently changed America for the worse (e.g., Beard 1948, esp. 573–98; Barnes 1980a, 1953).

Old Right thinkers did not confine their analysis to militarism's and socialism's poisoning of man's material circumstances. Harm to the spirit loomed just as large. In poignant essays Leonard Read and F. A. Harper emphasized people's deep need for freedom from coercion and the withering effects of political power. A former Cornell University economics professor who eventually founded the Institute for Humane Studies, Harper discussed such issues in his 1951 essay "In Search of Peace":

> Charges of pacifism are likely to be hurled at anyone who in these troubled times raises any question about the race into war. If pacifism means embracing the objective of peace, I am willing to accept the charge. If it means opposing all aggression against others, I am willing to accept that charge also. It is now urgent in the interest of liberty that many persons become "peace-mongers." (Harper 1979a)

Harper proceeded to reject the stock rationalizations for state-sponsored collective security and the militarism it invariably brings. Then, confronting head-on the bedrock case for the Cold War as propounded by "conservatives," he wrote:

> Relinquish liberty for the purposes of defense in an emergency? Why? It would seem that in an emergency, of all times, one needs his greatest strength. So if liberty is strength and slavery is weakness, liberty is a necessity rather than a luxury, and we can ill afford to be without it—least of all during an emergency. (Harper 1979a, 2:386)

Read matched Harper's poignancy in *Conscience on the Battlefield,* a pamphlet published during the Korean War in 1951. In an exchange between a soldier dying of a war wound and the soldier's conscience, Read set forth a theory of personal responsibility that did not permit the excuse "I was only following the state's orders" (Read 1951, 8–9). Read's essay was not a mere lofty flight of philosophy, but a tough-minded analysis of foreign

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policy and world events. The soldier's "conscience" points out that the soldier would not have chosen to defend the South Koreans against the North Koreans.

> And for good reason. In many instances, you recognize your incompetence to assign causation even to your own acts. It is, therefore, next to impossible for you to determine the just from the unjust in cases that are remote to your experience, between peoples whose habits and thoughts and ways of life are foreign to you.... You are as unaware of the forces at work in this Asiatic affair as you are of the causes of the quarrel between two headhunters. Am I wrong? If so, why have you been shooting Koreans and Chinese when the Russians are supposed to be the ones you fear? Are you expecting the North Koreans or the Chinese to invade the American shores? (Read 1951, 12–13)

In Chodorov, Read, and Harper we find representatives of the pure "libertarian," or laissez-faire, branch of the Old Right. This branch proclaimed a philosophy of private property, free trade, and free emigration—in short, pure capitalism.[45] Its members attacked wage and price controls, rent control, farm-price supports and crop controls, government education, inflation, and other interference with peaceful commerce.[46]

Meanwhile, three women writers—Ayn Rand, Isabel Paterson, and Rose Wilder Lane—extolled capitalism on a more spiritual level. Rand, whose novella *Anthem* was first published in the United States by Read, went on to construct an entire philosophy of reason and individualism whose political component justified natural rights, including property rights. The spirit of individualism that infused this group can be seen in Paterson's 1943 book, *The God of the Machine*. "The application of science to production," Paterson, a journalist, wrote, "requires assured possession of private property, free labor, and time enough to return benefits for the effort and capital expended....[A] man can think and work effectively only for himself" (Paterson 1943, 17).

Lane, a newspaper woman, novelist, and one-time communist, published her "Credo" in the *Saturday Evening Post* in 1936.[47] She described a trip to the Soviet Union and her crisis of faith as a communist. "I came out of the Soviet Union no longer a communist, because I believed in personal

45. They were inspired by F. A. Hayek's vastly popular 1944 book *The Road to Serfdom*, which argued that government economic planning leads to totalitarianism. The works of Ludwig von Mises were also critical in shaping their views on economics.

46. On several occasions Chodorov called for tuition tax-credits for parents who send children to private schools. He also trenchantly attacked government debt, headlining the July 1948 issue of *analysis* "Don't Buy Bonds."

47. "Credo" was reproduced as *Give Me Liberty* (1977). Lane was the daughter of Laura Ingalls Wilder of *Little House on the Prairie* fame. See also her *The Discovery of Freedom: Man's Struggle Against Authority* ([1934] 1984).

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freedom," she wrote. Freedom, the "anarchy of individualism," was responsible for the creation of great wealth and an unprecedented standard of living for more people than ever before. But this was in jeopardy from the "planned" economy. She protested: "Free thought, free speech, free action, and freehold property are the source of the modern world. It cannot exist without them. Its existence depends upon abolishing these reactionary state controls and destroying the socialist State" (Lane 1977).

The laissez-faire wing pushed its philosophy into areas where most "conservatives" preferred not to see it applied, for example, free trade and free migration. V. Orval Watts, writing in Chodorov's *Freeman* in 1955, called for legalization of trade with the Soviet Union. Rejecting both trade embargoes and government-subsidized trade, Watts, an author and educator associated with the Foundation for Economic Education (FEE), argued that free trade in goods would have an inevitable by-product, the export of American ideas:

> An American, for example, cannot walk down a Moscow street without conveying to passersby certain truths about the outside world—through the quality of his shoes, the cut of his clothes, his unafraid bearing and peaceable manner. Everywhere he goes, and in every contact, he does or says things which teach the meaning of freedom and expose the lies on which the Soviet rulers depend for inculcating fear and hatred of capitalism and of the peoples practicing it.[48]

Similarly, two other writers associated with Leonard Read, Oscar W. Cooley and Paul Poirot, called for a policy of free immigration. They regarded the freedom to come to America as merely an application of the founding ideals of the republic. Their pamphlet answered the stock objections to open immigration. For example, to the objection that newcomers might not assimilate, they responded,

> The assimilation of a foreign-born person is accomplished when the immigrant willingly comes to America, paying his own way not only to get here but also after he arrives, and peacefully submitting to the laws and customs of his newly adopted country. (1951, 14–15)

To the charge that the "wrong kind" of people will come, they said,

48. Watts 1955, 295. The connection between peace and free trade has recurred throughout the *Freeman*'s long life and up to the present. See Bettina Bien Greaves's article on foreign policy and free trade in the *Freeman*, September 1979, and Frank Chodorov's "The Humanity of Trade," in July 1956, in which he wrote, "Perhaps the removal of trade restrictions throughout the world would do more for the cause of universal peace than can any political union of peoples separated by trade barriers." Both articles are reprinted in Joan Kennedy Taylor, ed. (1986).

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> The danger that "a poorer class" might come from Asia or Africa or Southern and Eastern Europe and contaminate our society, undoubtedly seems real to any person who thinks of himself as a member of a superior class or race. Such a person, like any good disciple of Marx, is assuming the existence of classes and is convinced that he is qualified to judge others and to sort them into these classes. (1951, 16)

They concluded:

> Our present policy toward immigrants is consistent with the rest of the controls over persons which inevitably go with national socialism. But the controlled human relationships within the "welfare state" are not consistent with freedom.[49]

Such positions shed light on how the Old Right used the word *isolationist.*

The issue of Joseph McCarthy seems to have presented a dilemma for some Old Rightists. They hated communism, yet they saw the threat—to economic and civil liberties—of an anticommunist crusade directed abroad or at home. For some Old Rightists, the McCarthy phenomenon had irresistible features: directed against some of the darlings of the liberals, the people who had pushed the United States into a wartime alliance with the Soviet Union and who used "McCarthyite" tactics against the isolationists, it was also a movement not under the control of the despised eastern establishment. But McCarthyism presented risks, including the glossing over of similarities between communism and any form of statism. In 1949 Flynn wrote,

> I insist that if every Communist in America were rounded up and liquidated, the great menace to our form of social organization would be still among us. I do not mean to underestimate the danger from the Communists.... But they are not as dangerous to us as another wholly indigenous movement. The leaders of this movement now actually seek to outdo us in berating the Communists with whom they were marching together but two or three years ago. They are more dangerous because they are more numerous and more respectable and they are not tainted with the odium of treachery. (9)

The dangerous group he had in mind consisted of the British-style Fabians who sought to gradually fasten complete government control of the economy on the American people. Although Flynn supported McCarthy's efforts for a while, his reservations made him an atypical McCarthyite (Radosh [1975] 1978, 267ff.).

49. Cooley and Poirot 1951, 33. Another FEE pamphlet worth noting is Dean Russell's *The Conscription Idea* (1953), which attacked the draft as "the abolition of liberty."

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Felix Morley harbored another kind of objection to McCarthyism. His devotion to the rule of law made the McCarthy hearings troubling to him. Writing in *Barron's* in 1954, he recalled the origins and importance of the Fifth Amendment and how it had become a point of contention between McCarthy and his targets.

> This ancient Anglo-Saxon safeguard against confessions exacted by torture has ironically become the chief defense of people who would probably indorse "brain washing" if they were themselves in power. But to fight Communism with Communism, as Norman Thomas points out...is "losing to our enemy by imitating him."[50]

"Properly understood," Morley (1954) wrote, "the issue of McCarthyism is thus seen to be one of legislative encroachment on the judicial function, which students of American history will recognize as a problem that plagued this country long before Karl Marx was born or thought of" (9).

Chodorov made perhaps the most fundamental case against McCarthyism. He couldn't understand how it was determined who questioned whom in the "heresy trial."

> What is it that perturbs the inquisitors? They do not ask the suspects: Do you believe in Power? Do you adhere to the idea that the individual exists only for the glory of the state? Ought not the TVA be extended to cover the whole country, so that by merely pulling a switch the State can control all production? Are you against taxes, or would you raise them until they absorbed the entire output of the country? Are you opposed to the principle of conscription? Do you favor more "social gains" under the aegis of the bureaucracy? Or would you advocate the dismantling of the public trough at which these bureaucrats feed? In short, do you deny Power?
>
> Such questions might prove embarrassing to the investigators. The answers might bring out the similarity between their ideas and purposes and those of the suspected heretics. They too worship Power. Under the circumstances they limit themselves to one question: Are you or were you a member of the Communist Party? And this turns out to mean, have you aligned yourself with the Moscow branch of the church? (Chodorov 1962, 282; originally in *analysis* [September 1948])

Chodorov (1950) suggested a way to rid the government of reds: "Just abolish the jobs." He repeated this proposal in *Human Events* in his article

50. Morley 1954, 9. Morley was also unenthusiastic about the Alger Hiss case. See Morley 1979, 430.

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"McCarthy's Mistake": "The only thing to do, if you want to rid the bureaucracy of Communists, is to abolish the bureaucracy." He urged Senator McCarthy to turn his attentions to government appropriations.[51]

In the midst of this radical analysis, the other "right wing" was gearing up for a fight. Signs of tension between the old and new had appeared in *Human Events*, in which William Henry Chamberlin endorsed NATO and McCarthy and admonished the "isolationists":

> Whichever camp Americans may have belonged to before Pearl Harbor, present conditions dictate the following conclusions: The world has become too small for a big country like the United States to hide in. In the face of the undisguised Communist ambition to conquer the world by force, subversion, or a mixture of the two, there is no peace in appeasement, no safety in retreat, no security in cowardice. (Chamberlin 1958)

Chamberlin would become quite loose with such accusations. Reviewing the Old Rightist Louis Bromfield's 1954 antimilitarist book, *A New Pattern for a Tired World,* Chamberlin wrote that the author "finds himself in the company of Kremlin apologists." Later he red-baited Murray N. Rothbard and the businessman Ernest T. Weir for antimilitarist articles in Old Right journal *Faith and Freedom*. Writing in the virulently pro-Cold War, social democratic magazine *New Leader*, Chamberlin branded Rothbard and Weir "appeasers" and said that Rothbard laid "down a blueprint for American policy tailor-made to the specifications of the Kremlin" (quoted in Rothbard n.d., 139).

As early as 1949 Morley was headed for a break with his *Human Events* partner Frank Hanighen. According to Morley, Hanighen wanted to boost circulation by exploiting distrust of the Russians. Morley feared that would encourage militarization. The climax came with the triumph of the communists in China. "So, in the over-simplified jargon of the times, I became Isolationist, while Frank Hanighen moved to Interventionism" (1979, 436). In 1950, when Morley failed to buy out Hanighen and the other *Human Events* stockholder, the publisher Henry Regnery, and to take control of the newspaper, they bought him out.

> In retrospect I see this episode as symptomatic of that which has come to divide the conservative movement in the United States. Frank and Henry, in their separate ways, moved on to associate with the far Right in the Republican Party. My position remained essentially "Libertarian," though it is with great reluctance that I yield the old terminology of "liberal" to the socialists.... The vest-

51. Chodorov 1952a, 1. This should dispose of the claim, found in Gottfried and Fleming (1988, 6), that Chodorov was an enthusiastic McCarthyite.

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> ment of power in HEW is demonstrably bad, but its concentration in the Pentagon and CIA is worse because the authority is often concealed and covertly exercised. (Morley 1979, 437)

The coming break was also previewed in 1954, when William F. Buckley, Jr., wrote "A Dilemma of Conservatives" in the *Freeman*. A one-time disciple of Nock and Chodorov, Buckley, using the terminology "containment conservatives" to describe the Old Right and "liberation conservatives" to describe the New, acknowledged the deep disagreement regarding the Soviet Union. He also acknowledged that the liberation conservatives' program would involve policies contrary to American tradition: "For to beat the Soviet Union we must, to an extent, imitate the Soviet Union." But, he argued, the liberationists maintain "there is in the long run less danger involved in mobilizing with the view to achieving a certain objective as fast as feasible than in adapting ourselves to a perpetual state of mobilization of the kind we would need to have if we were to aim at an uneasy modus vivendi." He finished the discussion with a prediction that the differences "ultimately...will separate us." Buckley did not specify who was advocating a "perpetual state of mobilization," but this was the very condition that the Old Right opponents of the Cold War were warning against. Presumably the only way to achieve "as fast as feasible" the objective of ending Soviet communism was to launch a war against Russia.[52]

The separation became more overt in the next issue of the *Freeman*. In his editorial "The Return of 1940?" Chodorov said the current debate over whether to postpone the struggle for freedom until the Russians are defeated reminded him of the debate in 1940 over whether the struggle should be postponed until Hitler was defeated (his answer was no). As an aid in the current debate, he wished to catalogue the results of the intervention of the 1940s to see if the isolationists had been right. The war, he wrote, brought a huge debt, high taxes, conscription, a growing bureaucracy, and a loss of personal independence. The isolationists had predicted these outcomes because they knew that "during war the State acquires power at the expense of freedom, and that because of its insatiable lust for power the State is incapable of giving up any of it." Chodorov predicted that another big war would bring the end of "our inalienable rights." "This is admitted by those who fear the Soviets at least as much as they love freedom, but, as did the 'interventionists' in 1940, they stress the immediate rather than the ultimate danger, and are willing to gamble with freedom. I am not" (1954a, 81).

In the November 1954 issue the debate broke open with an exchange between Chodorov and William S. Schlamm, an Austrian former communist, one-time columnist for the *New Leader*, and adviser to Henry Luce.[53] In

52. Buckley 1954b. This was the second issue under Chodorov's editorial hand. In Chodorov's first issue, Buckley called for individualist education for discharged soldiers, who have been turned into collectivists by the military. See Buckley 1954a, 20–21.

53. Schlamm would later be a founder of *National Review*.

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"But It Is Not 1940," Schlamm characterized Chodorov's position as "unmitigated frivolousness" and asserted that the communists were in deadly earnest about conquering the world (preferably without war), that they were not receptive to reason, and that an unarmed America would be at their mercy. While isolationism may have been a reasonable position in 1940, it was not in 1954.

The same issue carried Chodorov's reply, "The War to Communize America," in which he began by noting that the advocates of war with Russia acknowledge that conscription is needed, as it was necessary in World Wars I and II and in Korea.

> That raises a pertinent question: if Americans did not want these wars should they have been compelled to fight them? Perhaps the people were wrong in their lack of enthusiasm for these wars, but their right to be wrong cannot be questioned in what we call a democratic system. Those who presume to compel people to be "right," against their will, are taking unto themselves a mandate for which there is no warrant other than their own conceit. Did God select them to do the coercing? (1954, 172)

Chodorov said he couldn't escape seeing a pattern regarding the preparation for war. He looked at the pattern this way: The people are frightened into thinking that the enemy will invade and conquer. Yet after previous wars it was learned that the enemy contemplated no such action. Are things really different this time? "But I am not frightened," he continued, "because I am not convinced of the world-conquering potential of the Moscow gang, or of their ability to invade my country. If I were, or rather, if the youth of my country were, we could dispense with the 'selective service' buncombe" (1954b, 172).

The war advocate thinks he wins his case, Chodorov wrote, by asking whether one would prefer to give one's freedom up to an American or a Russian dictator. In reality, there is no choice. "The suggestion that the American dictatorship would be 'temporary' makes this whole argument suspect, for no dictatorship has ever set a limit on its term of office." He added as an aside that a foreign invader would be easier to overthrow than a homegrown ruler, and he maintained that to reduce the danger of war, the United States should withdraw its troops from Europe and Asia and "abandon...global military commitments." If Russia then moved into western Europe, it would mean one of two things: either the Europeans wanted communism, in which the United States would have no right to interfere, or they were unwilling victims, in which case they would resist. The very attempt to conquer Europe would weaken the Soviet Union and hasten its collapse without the United States having to fight a war. And while the Russians were overextending themselves, America would be strengthening itself by husbanding its defenses and resources. "Of course, it would be hard on the Europeans if they fell into Soviet hands," Chodorov continued, "but

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not any worse than if we precipitated a war in which their homes became the battlefield.... The important thing for America now is not to let the fearmongers (or the imperialists) frighten us into a war which, no matter what the military outcome, is certain to communize our country" (1954b, 173–74). In response to those who warned Americans must fear the Russians, Chodorov declared, "I am more afraid of those who, like their forebears, would compel us against our will to fight the Russians. They have the dictator complex" (172).

Thus the debate was framed. In a letter to the *Freeman,* Buckley, who would soon start his own magazine, gave the decision to Schlamm. "I believe that we may indeed be facing both war and slavery," he wrote. "But we will have a fighting chance in a future war against the State, and I do not see that we will have a fighting chance to save ourselves from Soviet tyranny if we pursue Eisenhower's foreign policy—or Chodorov's. For that reason, I side with Willi Schlamm and number myself, dejectedly, among those who favor a carefully planned showdown, and who are prepared to go to war to frustrate the communist designs" (1955, 244). But Ralph Raico, future editor of the classical liberal *New Individualist Review*, had already issued a counterstatement: "William S. Schlamm made out the best case possible for war. After Frank Chodorov had finished his rebuttal, there wasn't much left on the opposition side."[54]

This debate was virtually replayed several months later, when Schlamm and Murray N. Rothbard, writing under the pen name "Aubrey Herbert," engaged in two exchanges in *Faith and Freedom* about whether the United States should go to war over Formosa.

By 1955, most of the Old Right stalwarts were gone. Taft died in 1953, McCormick in 1954. The Old Right publicists were getting old, and only a few younger ones had come along to take their place. In 1955, a key change occurred that doomed the Old Right and set back the movement for individual liberty for many years. Leonard Read and Frank Chodorov experienced various personal differences, and in order to force Chodorov out, Read decided to devote the *Freeman* to more abstract concerns, such as self-development, and to avoid ideological conflict; this move was a retreat from Chodorov's real-world analysis. When Chodorov left the *Freeman*, Buckley and his colleagues, former Trotskyists and Catholic theocrats, started *National Review*; the New Right now had a magazine under its own control.[55] The loss of the *Freeman* was disastrous for the Old Right, and the

54. Raico 1954, 202. This clash of letters between Buckley and Raico presaged debates in *New Individualist Review* seven years later.

55. Buckley had tried to buy the *Freeman* in 1955, but he was turned down (John B. Judis, *William F. Buckley, Jr.: Patron Saint of the Conservatives* [New York: Simon and Schuster, 1988], 114). Chodorov was listed as a contributor of *National Review* because of his longtime friendship (he was the only Old Rightist on the masthead), but he apparently had no influence at the magazine and did not work in the office. Among the former Trotskyists and communists were Willmoore Kendall, Whittaker Chambers, James Burnham, William Schlamm, Max Eastman, Morrie Ryskind, Freda Utley, Ralph de Toledano, and Eugene Lyons.

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group's inability to survive the shift demonstrates the already frail condition of the movement (see Rothbard n.d., 144).

With neither the *Freeman* nor *National Review* open to the Old Right's dissection of the world, the remnant had virtually no place to go. This predicament was demonstrated in 1956 when Flynn submitted a manuscript to *National Review* carrying forth his theme, developed in *As We Go Marching*, that militarism was a "job-making boondoggle," a "racket—the oldest in history," and an excuse for the government to tax and borrow (Flynn n.d.). Buckley rejected the article on grounds that its thesis "is difficult to defend in the absence of any discussion whatever of the objective threat of the Soviet Union." "As you know," Buckley continued, "my own opinion, and that of the other anti-socialists on *National Review*, is that the Communists pose an immediate threat to the freedom of every one of us."[56] The intrepid old Flynn, having gone from darling to outcast of the *New Republic*, had now traversed the same route at *National Review*. Of course he could not have published the article in the *Freeman* either after Chodorov's departure.

Without a magazine, it was difficult for the aging Old Right to attract new blood. Meanwhile, the New Right ascended thanks to the polish and surface sophistication of Buckley, his slick magazine, and, in 1960, the Young Americans for Freedom. The cause for nonintervention and limited government looked bleak.

Chodorov, who had worked so hard for the movement, never lived to see it blossom. He had a debilitating stroke in 1961 and died in 1966. Without him at the helm, his beloved Intercollegiate Society of Individualists (ISI) was renamed the Intercollegiate Studies Institute because the conservatives, reacting to the rhetoric of Students for Democratic Society in the early sixties, found the word *individualism* too left-wing and upsetting to businessmen.[57] Chodorov had seen the omens earlier and could not hide his exasperation. In a letter to *National Review* he wrote, "As for me, I will punch anyone who calls me a conservative in the nose. I am a radical" (Chodorov 1956).

Still, there were signs that his work would someday succeed. In 1961 a group of libertarian students at the University of Chicago started the quarterly *New Individualist Review (NIR)*, under the auspices of ISI, with Ralph Raico as editor in chief. For the next seven years it published the top and emerging scholarly advocates of individual liberty: Ludwig von Mises,

56. Buckley 1956. Buckley had asked Flynn to review *A Republican Looks at His Party,* by Arthur Larson, an adviser to Eisenhower. Flynn used the assignment to attack the militarism of the administration's policy toward the Soviets, a policy the *National Review* group thought was weak. See Judis 1988, 136.

57. Chodorov had begun ISI in 1952 as a way of keeping individualism alive for college students. He made Buckley its first president. See Rothbard n.d., 145.

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F. A. Hayek,[58] Milton Friedman (the last two were editorial advisers to *NIR*), Murray N. Rothbard, Henry Hazlitt, Yale Brozen, Israel M. Kirzner, George Stigler, and others. It also published revisionist history by Harry Elmer Barnes. Traditionalist conservatives were not excluded, however; Russell Kirk contributed to the third issue. Indeed, the editors continued the Chodorovian tradition of exploring the rift between the libertarians and conservatives: Buckley and Ronald Hamowy, a later editor in chief, squared off in the November 1961 issue, and Raico went up against M. Stanton Evans on the relationship between classical liberalism and religion in the Winter 1966 issue.[59] (*National Review* had never practiced this tradition.)

Besides *NIR*, a network of classical liberal organizations with greater staying power was quietly forming. Led by Read's Foundation for Economic Education, founded in 1946, it was joined by the William Volker Fund;[60] its successor, the Institute for Humane Studies;[61] Robert LeFevre's Freedom School;[62] Liberty Fund; and other organizations. This fledgling and underfunded network nourished young scholars, supported the work of older ones, and planted the seeds of the classical liberal, or libertarian, movement that would begin to flourish in the mid-1970s.

58. Almost as though his intentions were to inspire the *NIR* students, in 1960 Hayek had written "Why I am Not a Conservative" as a postscript to his treatise, *The Constitution of Liberty* (1960). Hayek wrote that "There is a danger in the confused condition which brings the defenders of liberty and the true conservatives together in common opposition to developments which threaten their different ideals equally" (397). For Hayek the "decisive objection" to conservatism was "that by its very nature it cannot offer an alternative to the direction in which we are moving. It may succeed by its resistance to current tendencies in slowing down undesirable developments, but, since it does not indicate another direction, it cannot prevent their continuance" (398). He criticized conservatives for being "inclined to use the powers of government to prevent change or to limit its rate to whatever appeals to the more timid mind. In looking forward, they lack the faith in the spontaneous forces of adjustment which makes the liberal accept changes without apprehension" (400). In sum, Hayek could not accept the "characteristic complacency of the conservative toward the action of established authority and his prime concern that this authority be not weakened rather than that its power be kept within bounds" (401). The *NIR* took this outlook to heart.

59. According to Ralph Raico, *NIR* at its height had a circulation of 1,500–2,000. The journal folded when the student-editors graduated and no replacements stepped in.

60. The Volker Fund, under Herbert Cornuelle, sponsored highly important conferences and meetings in the 1950s that featured such intellectuals as F. A. Hayek, Milton Friedman, James Buchanan, Bruno Leoni, George Stigler, and William Appleman Williams. Cornuelle also helped establish *Faith and Freedom*, an important late Old Right journal.

61. This institute was founded by F. A. Harper in 1961 in Menlo Park, California.

62. This organization was founded in 1956 by the former newspaperman.

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Rent Seeking Never Stops

An Essay on Telecommunications Policy

JAMES A. MONTANYE

Changes in U.S. telecommunications policy over the past two decades, culminating in the Telecommunications Act of 1996, have come to be regarded as the triumph of economic reason over regulatory chaos, whim, and incoherence. The trend away from central planning and control, and toward primary reliance on the market process, is consistent with a basic tenet of economic theory—that the market process provides the incentives for individual producers and consumers to make optimal use of price information, and so enables them to maximize the value inherent in telecommunicating. Less apparent is the direction of causality. Does regulatory change reflect a shift in government's regard for the principles of economics or, alternatively, is change the consequence of economic forces that government cannot control through status quo regulatory practices?

I shall argue in support of the latter conjecture, showing how telecommunications policy has been driven by the rational self-interest of government decision makers and how these interests have been constrained both by conflicting interests at different levels of government and by the private incentives of telecommunications users and entrepreneurs to make efficient use of technology by pushing the limits of restrictive regulatory policies.

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The essay begins with a consideration of conventional theories of regulation, emphasizing their inability to explain and predict the changes in telecommunications regulation that have occurred in the United States. Next, I introduce an alternative and more powerful theory of regulation, rooted in Public Choice analysis. Then, I describe pivotal changes in regulatory policies toward the telephone industry and interpret them in the light of this theory. (Only passing reference is made to broadcast regulation, a subject already explored in this context by several scholars.)[1]

Theories of Regulation

Several single-prong theories have been proposed over the years to explain the nature, function, and evolution of regulatory policies. Many of these have been offered as theories of telecommunications regulation. On close inspection, however, none of these theories, whether taken alone or in combination, adequately explains and predicts the course of telecommunications policy in the United States. These theories fail for many reasons. Some of them merely describe trends and events, whereas others consist of ethical notions about what regulation *ought* to accomplish and how it *ought* to be imposed. Most theories fail to account fully for the self-interest of government decision makers (politicians, bureaucrats, and judges), and few explicitly recognize the role of technological change and market forces as determinants of policy choice.

A successful theory of telecommunications regulation not only must account for the interest of decision makers and the role of technological change but also must integrate these forces in a rational and positive manner. A theory of regulation rooted in the principles of Public Choice theory can meet these requirements.

Conventional Theories of Telecommunications Regulation

Conventional theories can be divided into two groups for discussion: "public interest" theories; and political and economic theories. These theories are presented in several authoritative telecommunications texts,[2] and form the basis for popular and scholarly discussions of policy development and regulatory change.

1. See, for example, Coase (1959), Levin (1980), Hazlett (1990), Besen and others (1984), Ray (1990), and Krattenmaker and Powe (1994). The history related by these authors is consistent with the thesis that regulatory policies have been driven by the private interests of politicians, bureaucrats, and judges and, therefore, further belies the general notion that "public" interest considerations have been the force behind telecommunications regulation in the United States.

2. See, for example, Owen and Braeutigam (1978), Brock (1981), and Wenders (1987). More general discussions are given in Wilson (1980), Derthick and Quirk (1985), and Hawkins and Thomas (1989).

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The Public Interest Theory of Regulation

The Public Interest theory presumes that government decision makers are benevolent and omniscient and that laws and administrative rules represent honest, narrowly focused attempts to benefit consumers or to maximize some aggregate measure of social welfare. On this view, regulation is intended to prevent the pricing, output, and distribution problems caused by natural monopoly and other market imperfections. It does so by replacing the unfettered market process with rules such as earnings constraints and common-carrier responsibilities. Proponents of the Public Interest theory (and approach) sometimes acknowledge that regulation does not protect either the "public" interest or the specific interests of individual consumers as effectively as intended. They assert, however, that more desirable outcomes could be achieved *if only* regulations were more numerous and invasive, and *if only* enforcement efforts were increased.

The Public Interest theory of regulation plays well in public forums by virtue of its appeal to ethical and populist notions of fairness and equity. However, the theory is regarded as naïve by analysts who focus on the many drawbacks of regulation, including substantial direct costs and deadweight economic losses;[3] dubious "public" benefits; and evidence that regulation is a demonstrably poor substitute for the market process in constraining costs and prices and achieving optimal service and innovation. Economists in particular emphasize that the information needed to regulate in a rational manner simply is not available to regulators (Stigler 1975; Hayek 1988).[4]

Political and Economic Theories of Regulation

Political and economic theories acknowledge that regulatory policies turn on more than the supposed wisdom and benevolence of public officials. Even so, a bit of Public Interest theory remains in many of these perspectives. A few theories—some associated with particular authors, others

3. Historically, these burdens have been substantial, but they have declined recently in step with regulatory reform. The National Telecommunications and Information Agency (NTIA 1987) estimated the annual direct cost of telephone regulation in the United States to be $8 to $10 per local exchange line, about $2 of which was attributable to federal regulation. NTIA (1981) estimated the "deadweight" loss from the interstate toll-to-local subsidy to be about $1.6 billion annually. Wharton Econometrics (1986) estimated the indirect cost of the interstate toll-to-local subsidy to be about $50 billion in forgone GNP growth and 77,000 to 111,000 new jobs forgone between 1984 and 1991, all in addition to adverse consequences for state and federal tax revenues and the U.S. trade balance.

4. These concerns notwithstanding, the Public Interest theory of regulation is an implicit assumption of the economic literature on optimal telecommunications pricing under regulation. See, for example, Brown and Sibley (1986), Wenders (1987), and Mitchell and Vogelsang (1991). Absent a "public interest" assumption, the mathematics of optimal pricing become irrelevant, and little is left to write about.

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generic—recur in the literature on telecommunications regulation, and these are summarized next. This summary is not exhaustive, but representative and fairly encompassing.

The *Status Quo* theory (Owen and Braeutigam 1978). The purpose of regulation is to moderate the ebb and flow of wealth redistribution between consumers and producers. Regulation's failure to react swiftly and efficiently to changing conditions actually is an example of regulation's performing its intended function. A variation of this theory posits that the purpose of regulation is to buffer and balance the avarice of public utility firms against the confiscatory tendencies of majoritarian democracy.

The *Mediation* theory (Baldwin 1975). Producers and consumers desire an independent third party to mediate and arbitrate ongoing transactions. Regulation plays this role by providing a forum, ground rules, and referees.

The *Social Contract* theory (Goldberg 1976). Regulatory authorities act as consumers' agents by negotiating and administering long-term contracts with suppliers. Many of the regulatory initiatives introduced at the state level during the 1980s bore the "social contract" label. These initiatives typically focused on deregulation and "incentive" measures, however, and so were unrelated to the Social Contract theory.[5]

The *Economic* theory (Stigler 1971; Peltzman 1976). Interest groups "demand" (and bid competitively for) regulations that foster strategic objectives. Government "supplies" (sells) regulation in exchange for political capital, votes, private-sector jobs, and other rewards. Regulatory policies favor the highest bidders.

The *Capture* theory. Regulation is introduced in a public-interest vein, but subsequently becomes the captive of special interests. When regulation is captured by the industry being regulated, it becomes a form of cartel management. Capture theory is a forerunner of the Economic theory of regulation.

The *Taxation* theory (Posner 1971). Regulation is an extension of the "tax and spend" business of government. It is used to redistribute wealth in ways less likely to be countenanced if attempted through visible legislation.

5. Telecommunications reform adopted in 1987 by the Vermont legislature and implemented by the Department of Public Service actually was styled as a negotiated contract between New England Telephone and the state of Vermont, and so paralleled the Social Contract model quite closely. Vermont was unique in this regard.

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Each of these theories describes some observable aspects of telecommunications regulation, but no theory adequately explains or predicts the policy changes in the United States during the last two decades. On the one hand, regulation has perpetuated the status quo by delaying both the introduction of new technology and services and the entry of new suppliers. Continued regulation in the absence of natural monopoly or serious market imperfections suggests some fundamental demand for regulatory services. The fluidity with which professionals rotate their employment among regulatory, legislative, legal, consulting, and corporate venues is consistent with the doleful predictions of the Capture and Economic theories. Cross-subsidies are consistent with the Taxation theory.

On the other hand, none of these theories adequately explains some critical aspects of telecommunications policy. Contrary to the predictions of the Economic and Capture theories, regulatory policies frequently placed the resourceful and politically powerful telephone companies at a competitive disadvantage vis-à-vis their entrepreneurial rivals. The burden of cross-subsidization was borne mainly by a relatively small number of high-volume toll (long-distance) consumers, while the benefits were spread across the politically unorganized body of residential exchange subscribers—exactly the reverse of the dispersed burdens and concentrated benefits predicted by the Economic theory. The Taxation theory is undermined by the fact that the first telecommunications services to be opened to competition were those that had been taxed most heavily by regulation. And none of these theories predicts that a regulatory agency would adopt reforms that reduce its scope of authority and responsibility.

The shortcomings and contradictions of conventional theories indicate the need for a more powerful theory.

Public Choice Theory

In a general sense, each of the theories just identified is a theory of "public" (or "collective" or "social") choice to the extent that each attempts to explain and predict the course of government policy. More narrowly, however, a central core of principles constitutes a formal theory of Public Choice, which can be described as "the economic study of nonmarket decision making, or simply the application of economics to political science" (Mueller 1989, 1). Beyond this core, Public Choice splits into various schools, each emphasizing a particular subset of principles in order to answer specific kinds of questions.

My focus is on "rent seeking" (essentially, the pursuit of benefits created by government favoritism) and its relationship to telecommunications regulation. This focus, associated most closely with the Virginia School of Public Choice, uses constructs of positive economics to explain the

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process of nonmarket (public) decision making and to predict the course of policy choices. The approach explains policies in static terms by relating them to the private utility function of government decision makers, and explains the dynamics of regulatory process by relating change to the conflicting interests and changing opportunities of decision makers.

Public Choice Theory and Decision-Making Incentives

A fundamental premise of Public Choice theory is that all government decision makers—legislators, bureaucrats, and judges—have private interests that may be furthered by the regulatory process. This view of regulation parallels Adam Smith's (1776) well-worn observation that "[i]t is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard for their own self interest." Smith's insight is projected into the realm of regulation with just a bit of rewording: it is not from the benevolence of the politician, the bureaucrat, or the judge that we expect our regulatory policies, but from their regard for their own pecuniary, moral, ethical, aesthetic, and political self-interest. The point of this wordplay is to emphasize that regulators, like all individuals, place positive value on their own interests. This hard-headed view of regulation often meets with resistance, notwithstanding an abundance of corroborative empirical and anecdotal evidence. For purposes of theory building, however, the private interests of regulators must be taken explicitly into account.

The self-interest of regulators consists of a utility function comprising several variables: desire for reelection or reappointment to office; alternative career opportunities; other remunerations, such as travel, honoraria, campaign contributions, and side payments; administrative budget maximization; personal self-esteem, power, prestige, and privilege; private satisfactions that come from shaping the world according to personal preferences; and the pleasure that flows from doing the kind of cerebral, white-collar work that regulation involves. Accordingly, Public Choice theory views politicians and bureaucrats as entrepreneurs, and political parties as business organizations that produce economic rewards for their creators and patrons (Buchanan and Tullock 1962). Laws and regulations are viewed as aspects of contracts between public decision makers and private factions (Landis and Posner 1975).

Judges are somewhat removed from these base incentives, because of the greater individual responsibility and accountability attached to legal decisions and, for the federal judiciary, their lifetime tenure. Even so, judges derive private utility by reshaping legislation and administrative decisions and otherwise transforming society in ways that satisfy personal moral, ethical, cultural, and political preferences (Berger 1977). One need not deny that judges also may derive utility from deciding issues within established

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legal constraints (Posner 1995). One merely recognizes explicitly that the utility function of judges is complex—more so than tends to be acknowledged.

As predicted by the Economic theory of regulation, regulators capture private benefits by providing—and by promising and threatening to provide—redistributive rules (Stigler 1975; McChesney 1987 and forthcoming). These benefits are termed "rents," and their systematic pursuit "rent seeking" (Buchanan, Tollison, and Tullock 1980).[6] Regulatory rents are created whenever regulators use the power of the state to fetter the market process and thus redistribute wealth among competing parties. Wealth redistribution can be effected in many ways, including those described by conventional theories of regulation: taxation; status quo maintenance; prospective employment; and so forth. Where the self-interest of regulators dominates the decision-making process, regulatory policies are consistent with the "public" interest only to the extent that private and public interests happen to coincide—that is, by coincidence.

Government's ability to generate rents creates an inherent bias toward regulation. The market process, the alternative to regulation, is less attractive because it dissipates the portion of producer surplus captured as decision-making rents. Although the unfettered market process usually creates a larger economic surplus than does regulation, the surplus can be converted into rent only through visible taxation, an obvious drawback that constrains rent potential and, therefore, favors direct regulation. If regulation did not create rents, its continuation would have no value apart from Public Interest objectives that, because of information limitations, are unlikely to be achievable in any event.

The ability of decision makers at all levels of government to capture decision-making rents by taking and redistributing private wealth has grown substantially during the twentieth century. University of Chicago law professor Richard Epstein (1985) characterizes this "taking" power as follows:

> In instance after instance the Court has held state controls to be compatible with the rights of private property. The state can now rise above the rights of the persons whom it represents; it is allowed to assert novel rights that it cannot derive from the persons whom it benefits. Private property once may have been conceived as a barrier to government power, but today that barrier is easily overcome, almost for the asking.... Under the present law

6. More generally, a "rent" is a gain that accrues to the owner of property rights whose supply is fixed. A common example is the price premium collected by monopoly suppliers of goods and services. My focus is on the rents that flow from the monopoly of decision-making authority vested in regulators.

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> the institution of private property places scant limitation upon the size and direction of the government activities that are characteristic of the modern welfare state. (x)

The increasing authority of government to take and redistribute wealth has caused government at all levels to redefine its role in redistributional terms, as documented by Lowi (1979), Peltzman (1980), Tullock (1986), and many others.

Regulatory rent seeking creates a myriad of economic burdens in addition to the administrative costs and the losses associated with market distortions. In a rent-seeking environment, private factions expend resources for lawyers, lobbyists, consultants, and others, in an attempt both to capture regulatory rents for themselves and to protect against predatory rent seeking by others. When rent seeking is successful, adversely affected groups expend resources to circumvent the arbitrary restrictions that give rise to their burdens. Although such activity is privately rational, it is socially wasteful (Posner 1975; Bhagwati 1982). It is also a natural consequence of representative democracy. Vesting decision-making authority in selected individuals creates property rights that those individuals, as rational utility maximizers, have an incentive to allocate in ways that increase personal utility. In other words, rational decision makers can be hypothesized to act in ways that maximize the value inherent in the private right to decide public issues.

Cooperative action among regulators can increase decision-making rents. However, differences in the utility functions of decision makers at, and within, the different levels of government foster competition that prevents decision-making rents from being jointly maximized. Federal judges, for example, operate outside the legislative and regulatory process, and so their utility functions differ from (compete with) those of legislators and public utility regulators. Differences of this sort also exist between state and federal decision makers. Within regulatory agencies, differences exist between commissioners and staff professionals (lawyers, economists, accountants, and engineers). The hierarchical structure of government implies that regulatory policies are determined in part by the pulling of rank—legislatures trumping courts, courts trumping regulators, federal regulators trumping state regulators, and commissioners trumping staffers. Majority voting rules at all levels of government permit coalitions of decision makers to trump minority interests.

Rent-seeking incentives give rise to regulatory policies that appear (at least from a distance) to be arbitrary and incoherent. A decision-making majority can, in theory, adopt virtually any conceivable policy, given plausible assumptions and circumstances (Mueller 1989). This understanding

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has led political scientists, economists, and an increasing number of judges to dismiss the importance of "intent" when interpreting statutes and regulatory rules, not only because the rules are likely to be self-serving but also because of the ease with which underlying documentation can be distorted and falsified (Farber and Frickey 1991).

Regulation, Monopoly, and Competition

Private industry, like government, may have good reasons to prefer regulation to the market process. As a rule, no industry offered the opportunity to be regulated as a public utility should decline it and, historically, few have done so (Owen and Braeutigam 1978). Regulation offers protected markets; freedom from irksome competitors, demanding customers, and annoying antitrust constraints; and reduced business and financial risks. Regulated firms are in a unique position to capture pecuniary and nonpecuniary rents that would be bid away by unfettered competition. In short, regulation offers "the good life" to industries and firms that play the regulation game effectively. Accordingly, industries have an incentive to strive for regulation and, upon attaining it, to cooperate with regulators in ways that increase the regulatory rents captured by both factions. The result is akin to the cartelization of any industry, except that regulators use the coercive power of the state to manage the cartel.

As in any cartel, members of a regulatory cartel often discover opportunities to benefit themselves at the expense of their partners. Regulated firms find opportunities to capture profits in ways that regulators would disapprove, and so firms become selectively economical with information. Regulators find opportunities to build political capital by heckling and coercing firms. Possibilities for opportunistic behavior prevent a cartel from maximizing the joint rent over the long run. So long as a modicum of discipline and trust is maintained, however, regulation generates rents for government and industry factions and continues until perturbed by outside forces.

Entrepreneurs too have an incentive to support regulation, at least for other firms if not for themselves. They profit by selling into the gaps between supply and demand created by regulatory restrictions, and by using the machinery of regulation to hamstring competitors and to resolve disputes between themselves and regulated firms. Regulation facilitates business practices that otherwise would be actionable under antitrust law: tariff requirements, for example, allow price coordination and limit price shading.

Whether an entrepreneurial firm seeks to join a regulated cartel or, alternatively, to remain apart from it, depends on which alternative maximizes the present value of the expected profit stream, a matter that changes as regulatory policies and market conditions change. On the other side, a regulatory cartel will admit new entrants only if doing so maximizes the

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present value of expected future rents. If entry is inherently unsustainable, or if it appears that entry can be made unsustainable by means of strategic regulatory action, then a rational cartel will seek to crush entrants rather than taking them to its breast. Hence, entrepreneurs must enter regulated markets by force, pushing the legal limits of restrictive regulation until a suitable market niche is created. Entry under these conditions is costly and so is best attempted during periods of rapid technological change, when marginal costs are falling and product improvements are possible. These factors allow entrepreneurs to generate the cash needed to bear the burdens of litigation and political action and the high risk of failure.

Where entry is sustainable in the long run, the market process dissipates regulatory rents until status quo regulation is no longer worthwhile. At this juncture, regulation passes through a reformation that marks the end of one regulatory cycle and the beginning of another.

Telecommunications Policy in the United States

In this section of the essay, I sketch the trend of regulatory policy, focusing on key regulatory episodes involving telephone equipment and long-distance services. The purpose of this account is to show how policy change, including the antitrust divestiture of AT&T in 1984 and the Telecommunications Act of 1996, agree with the predictions of the positive theory of regulation developed above. I shall describe how the telephone industry evolved from an initial state of competitive chaos to become a regulated monopoly that benefited the industry and its regulators for nearly seventy years. As regulatory rents grew, entrepreneurs and consumers increasingly pushed the limits of regulatory restrictions. They were aided at key points by federal courts, which operated outside of the regulatory cartel and decided pivotal regulatory issues by their own lights, and by public utility regulators and legislators at different levels of government, whose divergent utility functions caused them to act at cross-purposes with one another. Formal moves toward regulatory reform occurred only after the capacity of regulation to generate sustainable rents had been substantially eroded. The Telecommunications Act of 1996 completed a cycle of creative destruction and laid the groundwork for a new cycle of rent seeking.

Some Early History

The factual history of telephony in the United States is well documented.[7] The telephone industry began chaotically, with many firms competing to

7. See, for example, Brooks (1975), Meyer and others (1980), Brock (1981, 1994), von Auw (1983), and Coll (1986).

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provide basic exchange service. The unwillingness of competing carriers to connect their systems meant not only that customers had to subscribe to the services of more than one carrier but also that the first carrier to acquire a critical mass of subscribers could buy out its competitors.

A key development in telephony was the introduction of long-distance service by the American Telephone and Telegraph Company (AT&T).[8] Long-distance service was especially valuable and therefore drew customers to the exchange carriers connected to AT&T's long-distance network. By refusing to connect rival exchange carriers, AT&T eventually consolidated the local exchange industry under its ownership. The justification for this consolidation—as articulated by AT&T's turn-of-the-century president, Theodore Vail—was the need for "one system, one policy, [and] universal service." Despite Vail's rhetoric, AT&T's consolidation of the industry raised antitrust concerns. By the time these issues came to a head, AT&T controlled exchange operations in the country's largest markets. In 1913, AT&T deflected antitrust action by promising to stop acquiring competitors and to begin connecting them to the long-distance network—the so-called Kingsbury Commitment. As a result, the clamor for antitrust action faded, and AT&T retained its portfolio of exchange companies. At the time of its divestiture in 1984, AT&T supplied roughly 85 percent of all exchange lines in the country through its ownership of the Bell System. The remaining 15 percent were supplied by roughly 2,300 "independent" carriers that varied greatly in size and geographic scope.

With long-distance connection available for the asking, and with its telephone patents expiring, AT&T again faced the problem of independent carriers nibbling at its business. When AT&T was a de facto monopoly, protected by patents and a proprietary network, it staunchly resisted government regulation. As competition for exchange customers increased, AT&T reversed its position and embraced regulation on the grounds that telephony was a natural monopoly, and that AT&T was the single entity best able to manage the monopoly in the public interest.

The high visibility and growing importance of telephony made the industry an attractive target for regulation by the Progressives, who viewed big business with great suspicion. AT&T and the telephone industry struck a Faustian bargain with state and national regulators, pursuant to which the "natural monopoly" of the telephone industry was recognized and preserved, both in fact and in law. In return, telephone carriers submitted to rate and

8. Switched long-distance service goes by many generic names, including "toll," "interexchange," "interLATA," "message toll service" (MTS), "message telecommunication service" (MTS), and "wide area telecommunications service" (WATS). Nonswitched services typically are called "dedicated," "point-to-point," and "private line."

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service regulations designed to ensure industry profitability while preventing carriers from pocketing a full measure of monopoly rents. The partnership of industry and state was symbiotic. AT&T's local and long-distance monopolies, which no longer could be sustained through aggressive defense of telephony patents and refusal to connect competitors, was sustained by the force of law. Government, in turn, built political capital by imposing "fairness and equity" constraints on the telephone industry. This arrangement remained remarkably stable for roughly sixty years, from about 1910 to 1970.

Throughout most of this period, the telephone industry retained absolute control over connections and attachments to its lines and equipment. This was accomplished by means of tariff language that prohibited "foreign" attachments of all kinds. The restrictions ensured, among other things, that rents could be generated from each dollar of investment in telephonic communications. These prohibitions were passively accepted for many years by telephone subscribers, who had little inkling of the opportunities being foreclosed.

Eventually, cracks appeared in the regulatory shield. Although seemingly trivial and insignificant, they nevertheless provided sufficient openings for entry into telephone equipment and long-distance service markets to occur. Entry gave rise to the creative destruction of status quo regulation.

Telephone Customer Premises Equipment (CPE)

The first crack resulted from the private manufacture and sale of a rubber cup, called the Hush-a-Phone, that slipped over the mouthpiece of a telephone handset. The device mimicked a human hand cupped around the mouthpiece, increasing privacy and reducing background noise. As innocuous as the device was, it nevertheless violated the industry's prohibition against foreign attachments. AT&T actively discouraged use of the device on the grounds that it was patently unlawful and potentially harmful. Hush-a-Phone Corporation brought the issue before the Federal Communications Commission (FCC), which ruled in 1955 that the device did indeed violate AT&T's tariffs and, therefore, was unlawful. On appeal, the federal court, seeing by its own lights, overruled the FCC by declaring that AT&T's tariff restrictions were neither just nor reasonable and, therefore, were themselves unlawful. The court reasoned that such broad tariff restrictions were "an unwarranted interference with the telephone subscriber's right reasonably to use his telephone in ways which are privately beneficial without being

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publicly detrimental."[9] By this decision the court imposed its own notions of fairness, equity, and social efficiency on the telephone industry and the FCC.

The *Hush-a-Phone* precedent opened the door for an inventor named Thomas Carter to market a device, called the Carterphone, that allowed subscribers to connect their telephone service with other telecommunications media, such as mobile marine radio. Such connections permitted them, among other things, to circumvent the expensive long-distance, mobile radio, and ship-to-shore services offered by the telephone industry. The connection was performed acoustically by placing the telephone handset into a cradle that contained a miniature microphone and speaker system. The Carterphone was a foreign attachment within the meaning of AT&T's tariffs, which proscribed all connections and attachments to the network "whether physically, by induction, or otherwise." AT&T proclaimed the device to be unlawful and threatened to terminate telephone service to any party caught using it. After nearly a decade of legal wrangling, the FCC ruled, consistent with the *Hush-a-Phone* precedent, that the restrictive provisions of AT&T's tariff were "unreasonable and unreasonably discriminatory."[10]

The *Hush-a-Phone* and *Carterphone* decisions nullified the industry's de jure monopoly of the connection and use of equipment that posed no threat of physical harm to the telephone network (the issue of "economic" harm had yet to be considered). The regulatory changes wrought by these decisions spawned the connection of customer-owned CPE of all sorts, including plain and fancy telephone sets, complex switching equipment (key telephone systems and private branch exchanges), modems, facsimile machines, alarm systems, and sundry other devices.

The upsurge of customer-owned equipment that followed *Carterphone* threatened to play havoc with regulatory policies at the state level. The reason lay in the accounting procedures, called "separations and settlements," by which regulators and the telephone industry shuffled costs and revenues between local and long-distance services and, in particular, between state and federal regulatory jurisdictions (Gabel 1967; NARUC 1971).

In the early days of telephony, accounts of connected carriers were settled by private negotiation and contracts. Settlements compensated carriers for the incremental cost of switching and distributing each other's telephone traffic. State regulators, who were burdened by Bell System demands for local rate increases, became concerned that AT&T was using settlement

9. *Hush-a-Phone Corporation v. Federal Communications Commission,* 238 F. 2d 266, 269 (1956).

10. *In the Matter of the Use of the Carterphone Message Device in Message Toll Telephone Service,* 13 F.C.C. 2d 420 (1968).

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agreements with its Bell System affiliates to concentrate profits in interstate long-distance operations. Interstate costs and rates, which were under Interstate Commerce Commission jurisdiction until 1934, when authority passed to the FCC, were beyond the legal reach of state regulators. For reasons to be discussed shortly, interstate regulators had little incentive to meddle in costs and tamper with rates.

State regulators could see that the cost of providing long-distance service was declining as the result of new technology and scale economies, and could see that interstate toll rates were not declining in step. They also understood that local rate increases could be mitigated if a means were found by which to capture a larger measure of interstate long-distance (toll) revenue than accrued under private settlement agreements. The task facing state regulators was to develop formal separations and settlements procedures that increased the proportion of exchange costs that "reasonably" could be attributed to interstate operations and, therefore, could be recovered from interstate toll revenues.

The plan for apportioning local exchange costs to interstate operations was driven by accounting, rather than economic, considerations. Most telephone plant is used to provide both state and interstate services. Some plant costs (the cost of telephone sets, for example) are "fixed" in the economic sense; that is, they are incurred regardless of whether any calls are placed or received. There is no basis in economic theory for apportioning fixed cost between services and regulatory jurisdictions. Rather, theory teaches that these costs are best recovered directly from the subscribers that cause them to be incurred. In the economic perspective, accounting rules for allocating fixed costs are arbitrary.

Attempts by the states to impose arbitrary separations rules provoked resistance from AT&T and the Bell System. The issue ultimately was resolved by the Supreme Court, which, applying Solomonic wisdom in a literal way, ruled that *all* exchange operating costs, including fixed costs, must be separated (divided) between regulatory jurisdictions on the basis of usage.[11] The separation of variable (marginal) costs on the basis of usage makes sense in economics, but the separation of fixed costs does not. It follows that the court's ruling was driven either by a faulty understanding of economics or by the judges' own notions of fairness and equity. In any event, the practical effect of the decision was to drive a de jure wedge between the economic cost of providing interstate long-distance service and the prices that had to be charged for it.

The gap opened by this wedge grew to astounding dimensions over time. When the Carterphone device came to market in 1960, the separations

11. *Smith v. Illinois Bell Telephone Company,* 282 U.S. 133 (1930).

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process allocated about 7 percent of fixed CPE costs on average to interstate long-distance operations. This meant that every $1.00 of fixed cost produced $0.07 in interstate settlement revenue. This revenue was a regulatory rent that state regulators were free to distribute in whatever manner suited them. For the most part, they used it to mitigate upward pressure on rates for residential exchange service, blending it into an overarching pattern of transfers that redistributed wealth from business to residential subscribers, from urban to rural subscribers, and (by virtue of especially long depreciation periods) from future to current subscribers.

Between 1956 and 1968, when it appeared that the *Hush-a-Phone* precedent could open the CPE market to competitive supply, the proportion of fixed equipment cost assigned to the interstate jurisdiction increased from 6 percent to 11 percent (Congressional Budget Office 1984). The figure reached 20 percent by 1975, and 27 percent by 1984. Interstate services could shoulder this increase because of falling transmission costs attributable to the increased use of microwave and broadband cable technologies. Separations procedures were adjusted periodically to absorb these cost reductions, in particular by weighting "relative-use" measures to shift a greater proportion of fixed cost to the interstate jurisdiction.[12] Regulators and the telephone industry negotiated these adjustments.

Increasing the interstate assignment of CPE costs suited state regulators because it mitigated pressure for local rate increases. It also suited AT&T and the telephone industry. First, it removed the need for AT&T to reduce interstate toll rates at a time when the Bell System's local operating costs were rising. Second, it removed the need for the Bell System to petition prickly state regulators for higher exchange rates. Third, it tied settlement increases to the continued provision of CPE by the telephone industry.

In contrast to the separations treatment of industry-provided CPE, the cost of customer-owned CPE was excluded from separation-and-settlements calculations. Consequently, any substitution of customer-owned CPE for industry-owned equipment directly reduced the interstate settlement fund. As customer-owned CPE captured market share—which was certain to happen, because this equipment was cheaper and feature-rich compared to industry-provided CPE—the rent accruing to state regulators would decline.

State regulators, AT&T, and the telephone industry resisted the FCC's

12. The rationale for the use of weights was rooted in the "deterrent" effect that toll charges had on relative-use percentages. Local exchange services were "flat rated," meaning that subscribers paid a fixed monthly charge for service and no incremental charge for local calling. In contrast, an incremental charge was incurred for each long-distance call. The tongue-in-cheek rationale behind the weighting scheme was that it approximated the relative-use proportions that *would have arisen* in the absence of toll charges. Given that the separation of fixed costs according to relative usage lacked a rational economic basis, the use of a weighted separations factor was no less arbitrary.

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Carterphone decision by actively opposing the connection of customer-owned CPE. So strong was this opposition that the FCC asserted primary jurisdiction over CPE policy in 1974 on the grounds that state regulators were frustrating the use of customer-owned CPE for interstate calling. State regulators responded by warning the FCC that its policies would have "a substantial adverse economic impact on local exchange telephone subscribers" (quoted in von Auw 1983, 411).

Long-Distance (Toll) Services

Pressure to liberalize regulatory policies governing the long-distance monopoly stemmed from three sources. First, the procedures for dividing costs between local and long-distance operations caused interstate long-distance service to be priced substantially above economic cost, much to the dismay of parties making a lot of interstate calls. Second, state regulatory policies caused state toll rates to be set arbitrarily high in order to subsidize local exchange operations. Third, newly developed microwave technology made it feasible for private firms to build and operate telecommunications systems.

Private use of microwave technology required the availability of frequencies and the FCC's willingness to grant licenses. AT&T and Western Union, adapting their own networks to microwave transmission at the time, argued strongly against the grant of private licenses on two grounds: the spectrum could not accommodate both common carrier and private systems; and the use of private systems would upset the delicate balance between common carrier costs and revenues and, therefore, threaten the universality of telephone service.

The "scarcity" argument was refuted by a comprehensive study of the available spectrum by the Electronic Industries Association, a trade group representing microwave equipment manufacturers. The argument that private networks would seriously and adversely affect industry revenues was dismissed on the grounds that the demand for private networks would be negligible. Moreover, owners of private networks could be prohibited from sharing and selling slack network capacity in competition with AT&T, and connection of private systems to the public telephone network could be prohibited absent a compelling case-by-case showing that such connection served the public interest.

Equity considerations supported the grant of private licenses. The toll-to-local subsidy meant that customers making heavy use of toll services (both state and interstate) bore a disproportionate share of the subsidy burden. Accordingly, the FCC decided to earmark frequencies for private

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microwave use and to grant licenses.[13] The decision was not seen as opening the long-distance market to competition but, rather, as providing a measure of relief to large firms, including many politically powerful defense contractors.

Entrepreneurs realized that private networks provided an opportunity to capture a portion of the monopoly rent created by regulation. To do so, they needed only to be certified as interstate common carriers. Once certified, regulatory restrictions against the sharing and sale of transmission capacity would become moot, as would restrictions prohibiting connection with the "public" network.

State regulators typically conferred de jure monopoly status on certified exchange and long-distance carriers. Federal regulation, in contrast, conferred no de jure monopoly on AT&T's interstate operations, although the Communications Act of 1934 did require prospective entrants to prove that certification would serve the public interest.

The first company to seek certification was Microwave Communications Incorporated (MCI), precursor of the MCI that exists today. An application was filed in 1963 for authority to supply dedicated channels for hire between St. Louis and Chicago. MCI's stated intention was to provide "specialized" services to customers unhappy with AT&T, which had come to regard its captive customers as demanding nuisances. In contrast, MCI saw these customers as business opportunities. In support of its application, MCI proffered copies of service complaints that AT&T's customers had lodged with the FCC. These complaints focused in particular on the poor quality of AT&T's data transmission services—the market niche in which MCI proposed to specialize. After six years of litigation brought by AT&T and supported by state regulators, the FCC voted 4–3 to certify MCI as a "specialized common carrier." Following another two years of litigation, MCI received authorization in 1971 to begin operations.

MCI's application ostensibly was approved on its merits. Nevertheless, the application had been made at a propitious time. In 1965, Congress—at the instigation of high-volume users of long-distance services—directed the FCC to investigate AT&T's interstate operations with an eye toward reducing interstate rates. It quickly became apparent that rational regulation of AT&T was impossible. Not only was the FCC understaffed and underequipped for the task; it was dependent on AT&T for all of the information needed to regulate. To mitigate the effects of these limitations, the FCC envisioned a scheme of limited competition in interstate services. William Melody, a professor of economics and FCC consultant, first articulated the idea in 1968. He presented it as follows:

13. *In the Matter of Allocation of Frequencies in the Bands Above 890 Mc.*, 27 F.C.C. 359 (1959).

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> The Commission could encourage the entry of new common carriers into submarkets the new carriers could supply efficiently.... By following such a policy, the Commission would be using the market force of competition as a regulatory tool in the prevention of monopolistic price discrimination. (von Auw 1983, 124)

The introduction of competition was not intended to be an optimal alternative to regulation but, rather, a tool for forcing AT&T to reveal its economic costs in the form of market-driven prices. The FCC's only alternative was to investigate rates on the basis of engineering cost studies, which AT&T as a regulated firm was able to prepare in superabundance and which, as a practical matter, defied independent verification.

AT&T's control of the numbers was not the FCC's only concern. The carrier's sheer size gave it considerable political leverage and, with that, a measure of arrogance and independence that rankled regulators and legislators at all levels of government. The introduction of limited competition appealed as a way to discipline AT&T and to restore a measure of power and prestige to regulators:

> MCI was unleashed, nurtured, protected, and defended by the FCC and [the U.S. Department of] Justice because, in the words of [former FCC Common Carrier Bureau chief] Hinchman's predecessor Bernie Strassburg, "AT&T was getting so big, so fast." Competition was a means for the government lawyers and bureaucrats to wrest power away from AT&T, to regain control over the phone company. Judge Greene [who presided over the government's antitrust case against AT&T], a former government lawyer himself, indicated clearly...that it was AT&T's size and power that troubled him above all. (Coll 1986, 373)

AT&T and state regulators fought MCI's entry with tooth and claw, earning for AT&T a place in the antitrust record books. By refusing to connect MCI's system with the public network and by engaging it in costly litigation, AT&T stunted the demand for MCI's services and dissipated any operating-cost advantages that it might have had over AT&T. Out of necessity and perhaps out of strategic planning, MCI abandoned its plan to provide specialized services and began to compete for AT&T's interstate toll business through an offering called "Execunet." In this market the potential profits were greatest, not only because of its sheer size, but also because of the wedge that regulation had driven between costs and prices. The limited introduction of competition had become a classic slippery slope.

At the urging of AT&T and state regulators, the FCC ordered MCI to

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cease and desist immediately on the grounds that MCI had not been authorized to provide toll services. (MCI characterized Execunet as a "switched private line" service in a rhetorical attempt to obscure its true nature.) The matter reached the federal court, which ruled, to the surprise of many, that the FCC's authority under the Communications Act of 1934 ended with the granting of operating authority.[14] In the court's narrow and independent view, the FCC lacked authority to dictate the services a carrier could offer once facility construction had been authorized. The Communications Act of 1934 did not contemplate the introduction of limited competition for regulatory purposes. The court's *Execunet* ruling ended AT&T's de facto monopoly over interstate long-distance services and set the stage for the industry restructurings that occurred in 1984 and 1996.

MCI, Sprint, and other entrants remained essentially free of FCC regulation from their inception. Through careful lawyering, however, they used administrative law and due process to hamstring AT&T with regulatory red tape. They used regulation effectively in other ways as well. For example, the FCC exempted these carriers from close regulatory scrutiny, at one point relieving them of the obligation to file and follow tariffs for interstate services. In the absence of tariffs, carriers could practice price discrimination by negotiating terms and conditions with individual customers. Industry profits would be eroded as entrants competed for business. MCI sued in federal court to prevent the FCC from removing tariff requirements. The court, accepting the legal merits of MCI's argument, determined that the Communications Act of 1934 required all carriers to file tariffs, and therefore reversed the FCC's decision. The consequent ability of carriers to coordinate prices and control opportunistic behavior facilitated supercompetitive toll rates.

Throughout this period, state regulators prohibited MCI and other entrants from providing state toll service in competition with AT&T and the Bell System, thereby protecting the rents that flowed from state regulatory policies. These restrictive policies were mitigated in 1984 by the AT&T antitrust settlement. Among other things, the settlement divided the country into approximately 160 geographic areas, called local access and transport areas (LATAs), within which the states had jurisdiction over toll services and between which the FCC had jurisdiction. Many states continued to prohibit toll competition within LATAs, a policy finally nullified by the Telecommunications Act of 1996.

14. *MCI Telecommunications Corporation, et al. v. Federal Communications Commission,* 580 F. 2d 590 (D.C. Cir. 1978).

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AT&T Divestiture

Aggressive resistance to competition by AT&T and state regulators hindered entrants desiring to sell CPE and interstate long-distance services. MCI filed a federal antitrust suit against AT&T in 1974, by which time CPE manufacturers and retailers also were preparing antitrust suits. AT&T's competitors also sought to widen regulatory cracks by lobbying Congress and the Justice Department for relief. The Department of Justice brought an antitrust action against AT&T in 1974, seeking in part to divest AT&T of its equipment manufacturing and local exchange operations. The suit, which succeeded in achieving its basic objectives, culminated in a settlement agreement styled as a *Modification of Final Judgement* (*MFJ*).[15]

The merits of the Department of Justice suit, as well as the provisions of the *MFJ*, commonly are assumed to reflect the application of economic principles to telecommunications regulation. The basis for this assumption appears in a comment by Roger Noll (1985), a professor of economics and influential commentator on telecommunications policy:

> Astonishingly enough, economics played a central role in changing federal telecommunications policy, as acknowledged by Philip Verveer, the lawyer who developed the antitrust case against AT&T, the Chief of the FCC's Cable Television Bureau when cable was deregulated, and the Chief of the Common Carrier Bureau when the FCC formally adopted the policy of minimizing federal regulation of telecommunications. The intellectual foundation of these policies is an economic case that the industry will be more efficient if it is minimally regulated and maximally competitive. (52)

In fact, the "intellectual foundations" to which Noll refers carried relatively little weight in the decisions leading up to divestiture.

The Justice Department's case certainly did not reflect a consensus among economists at the time. Many economists considered the telecommunications industry to be a natural monopoly and, accordingly, reasoned that the facilitation of competition through the atomization of AT&T would create tremendous inefficiencies. Other economists, who regarded a competitive telecommunications industry as inevitable, disagreed with the divestiture remedy. Lester Thurow (1980), for example, reasoned that

15. *United States v. American Telephone and Telegraph Company,* 552 F. Supp. 131 (D.D.C. 1982). The *MFJ* affirmed the provisions of a settlement agreement reached between AT&T and the Department of Justice in 1981. It was styled as a modification of the Consent Decree, entered in 1956, that settled the 1949 antitrust suit brought against AT&T and Western Electric by the Justice Department.

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> Technological advances will from time to time require changes in the rules of industrial competition. With the development of microwaves and satellites, the long distance transmission of messages may have changed from a natural monopoly to a potentially competitive industry. If so, rules and regulation governing the telephone business should be changed to reflect this development. Whatever should be done, however, the correct answer is not an antitrust suit against AT&T. A regulated monopoly should be governed by regulatory procedures and not by antitrust procedures. If the goal is a competitive industry in long distance transmission, an antitrust case is simply not the means for getting to this objective. Deregulation is best achieved by deregulation, not by a lengthy court case based on principles that have nothing to do with regulation and deregulation. (150)

A Department of Justice consultant similarly questioned the structural remedies being sought (Brock 1981):

> Taking an action (such as divestiture) is certainly not free. It imposes substantial legal costs on both sides and substantial managerial burdens for implementation. Insofar as industries are moving in the "right" direction, it may be more economical to allow them to do so than to impose significant changes through government actions. (300–1)

At trial, AT&T sponsored the testimony of several prominent economists, engineers, and foreign telecommunications administrators, each of whom described the proposed divestiture as ill considered. They had a point, as Coll (1986) noted:

> Certainly it is true that the government lawyers and bureaucrats at Justice and the FCC were not driven to break up the phone company by any clear, coherent vision about how a decentralized telecommunications system would work better than the existing one. The Justice lawyers, for example, never seriously believed that the operating companies would ever be divested, and until it became a necessity as the case was about to go to trial, they spent very little time drawing up plans for how the nation's phone network would be managed if they won their case. Instead, the government lawyers were driven by the conviction that AT&T was "unregulatable," as Walter Hinchman, the [FCC's] former Common Carrier chief, always put it. (373)

Except for the general notion that competition is preferable to monopoly, economic principles played a small role in the decision to reform the telecommunications industry through antitrust action.

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In the end, the Department of Justice and AT&T agreed on a settlement involving, among other things, the divestiture of AT&T's local exchange (Bell System) operations. Settlement terms were dictated by antitrust chief William Baxter, a law professor of the "law and economics" school who inherited the case from a line of predecessors. Baxter reasoned that, by separating AT&T's local operating companies from its long-distance operation, by removing toll-to-local subsidies, and by breaking the corporate link that obliged the Bell System to purchase the bulk of its equipment from AT&T's Western Electric subsidiary, the industry could develop more or less naturally along competitive lines.

The presiding judge in the AT&T case, Harold Greene, accepted the settlement agreement and added some key conditions of his own. In particular, he imposed line-of-business restrictions against AT&T and the divested "Baby Bell" companies. These prevented both entities from offering information services. They also prevented the Baby Bells from providing long-distance services between LATAs (which Greene was instrumental in designing) and from designing and manufacturing telephone equipment.

The *MFJ*'s information-services restriction against AT&T carried a "sunset" provision and expired naturally. The restriction against the Baby Bells was abandoned only after protracted litigation. So determined was Judge Greene to keep the restriction in place (even in the absence of a supporting evidentiary record) that the Federal Court of Appeals ultimately scolded the judge for abusing his discretionary authority and remanded his rulings. Judge Greene's concern was that the provision of information services by the Baby Bells would stifle diversity, an ironic "first amendment" argument pressed by the newspaper industry to preclude competition by the telephone industry (Mink 1989).

Many economists viewed the *MFJ*'s long-distance restriction as unnecessary and positively harmful to economic efficiency. By preventing the Baby Bells from competing in long-distance markets, the restriction prevented competition by the very entities best able to challenge the dominant AT&T-MCI-Sprint long-distance oligopoly. There is no compelling evidence that consumers benefited from the long-distance restriction. Rather, it facilitated supercompetitive long-distance charges. It was later nullified by the Telecommunications Act of 1996, as was the manufacturing restriction.

As the government's case against AT&T approached resolution, another federal judge a few doors down the courthouse hall was hearing an antitrust case brought against AT&T by Southern Pacific, the owner of Sprint. This case resembled the government's case against AT&T and was virtually identical to the case that MCI had brought successfully a few years earlier. It surprised many that in the Southern Pacific case, Judge Richey

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decided key issues in AT&T's favor and dismissed the suit, casting aspersions at Judge Greene and the *MFJ* in the process. Judge Richey was a former state regulatory commissioner and, as such, brought a potential conflict of interest to the case. Southern Pacific and AT&T specifically accepted the case assignment to Richey on the grounds that his experience and knowledge of telephony issues uniquely qualified him to hear the case. The regulatory theory of this essay would have counseled Southern Pacific against this acceptance.

Had the government's case against AT&T been assigned to Judge Richey instead of Judge Greene, telecommunications policy would have evolved much differently than it did.

The Telecommunications Act of 1996

Prior to 1996, Congress enacted no telecommunications policy legislation, apart from broadcasting and cable television rules, despite several attempts to do so over a twenty-year period. Early attempts to legislate reflected blatant efforts by the telephone industry and state regulators to subdue competition and maintain status quo policies. Legislative initiatives sponsored in the late 1970s would have obliged every telephone subscriber to accept (and to pay handsomely for) at least one industry-provided telephone set for each local exchange line. Initiatives to codify a telephone industry monopoly arose as the government's antitrust suit against AT&T gathered momentum. Subsequent to AT&T's divestiture, conflicting initiatives were undertaken to codify the *MFJ*'s line-of-business restrictions and, alternatively, to nullify them. Congress's inability to pass telecommunications legislation during this interval revealed both the ability of powerful factions to block legislation and the inability of any faction, no matter how powerful, to get legislation passed.

Initiatives aimed at the *MFJ*'s line-of-business restrictions were a principal focus of lobbying between January 1984 (the date of the AT&T divestiture and the creation of the Baby Bells) and the passage of the Telecommunications Act of 1996 ("the Act"). Long-distance carriers and professional consumer advocates opposed proposals to lift the long-distance restriction. Carriers argued that the Baby Bells had the motive, means, and opportunity to exercise "bottleneck" control over local exchange facilities in order to compete unfairly and therefore should be kept out of the long-distance business. Consumer advocates argued that the Bells would cross-subsidize long-distance operations by hiking rates for monopoly exchange services. Legislative proposals to lift the long-distance restriction consistently failed to garner enough support for passage, notwithstanding the assurance of many economists that market entry by the Bells would cause supercompetitive long-distance rates to fall.

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Efforts to nullify the *MFJ*'s manufacturing restriction generated more congressional movement, but not because of concern for the efficiency of telecommunications markets. Legislation offered in the Senate in 1991 would have permitted the Bells to design and manufacture telephone equipment if specific "domestic content" requirements were met. This condition was both irrelevant and contrary to rational telecommunications policy. It was consistent, however, with the private interests of trade unions, domestic competitors, and trade bashers. The legislation did not pass, but the episode illustrates the ease with which good intentions can be hijacked at their inception.

The Act nullified the remaining line-of-business restrictions imposed by the *MFJ* as well as several restrictions imposed administratively by the FCC. The Baby Bells became free to enter long-distance markets (an attractive opportunity given that long-distance markets are growing faster than local exchange markets), to provide cable television services, and to manufacture equipment. The cable industry, in turn, received rate deregulation (yet again) and became free to offer local telephone service, a significant opportunity given that cable service presently is available to about 90 percent of U.S. homes and 65 percent subscribe to it. The Act also freed long-distance carriers to enter the local exchange business, which receives 25 percent of its revenues from long-distance carriers, who pay over 45 percent of their operating revenues in return for access to exchange subscribers. Overall, the Act's various provisions are estimated to affect activities accounting for more than 15 percent of GNP.

The Act also benefits government decision makers. Among other things, it recodified the "public interest" standard of broadcast regulation and frequency assignments, thereby keeping program content at least nominally responsive to political pressure. The Act recodified the prevailing goal of "universal service" (a phone in every household) and extended this goal by requiring carriers to provide broadband services "to elementary schools, secondary schools, and libraries for education purposes *at rates less than the amounts charged for similar services to other parties*" (Sec. 254, emphasis added). This provision is less aggressive than the Clinton administration's proposal, which sought "free" service for government institutions.[16] The Act delegates the actual pricing of these services to the FCC and state regulators, an instance of "tax and spend" policies being decided behind a veil of public utility regulation.

The Act creates two new bureaucracies. One is the Telecommunications

16. See, for example, a report by *Telecommunications Week* (22 February 1994) concerning Vice President Gore's goal of "free" universal service to all schools and public institutions by the year 2000.

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Development Fund, to be administered by a not-for-profit corporation whose redistributive goals include promoting access to capital by small business; stimulating technology development and promoting job training and employment; and promoting the delivery of telecommunications services to "under-served" areas. The other is the National Education Technology Funding Corporation, whose goals include stimulating the development of telecommunications infrastructure for educational purposes; making loans and grants to schools and libraries to foster the application of telecommunications technology; and serving as a clearinghouse for technical information and technical assistance. Both entities are to be funded primarily from the proceeds of telecommunications spectrum auctions. Given that the auction of spectrum already has fetched several billion dollars, it follows that these bureaucracies will become major attractions on the rent-seeking circuit.[17]

Finally, the Act imposed various content controls on the transmission of information that is indecent, violent, or pertains to abortion.[18] These provisions raise First Amendment issues in addition to practical concerns about how the flow of such information can be controlled. The provisions appear to have been well intentioned. They also constitute blatant rents to ideological rent seekers.

The Telecommunications Act of 1996 contains something for everybody: All segments of the telecommunications industry are now free to exploit the supposed "synergies" of integration viewed as inherent in wireless and digital technologies; politicians and bureaucrats have new rules and bureaucracies that will yield decision-making rents over time. In view of its Christmas-tree character, it is not surprising that the Act passed with virtually unanimous consent—the vote in favor was 414–16 in the House and 91–5 in the Senate.

17. Congress historically opposed auctions as a means of distributing spectrum licenses. It acquiesced in the auction of Personal Communication Service (PCS) licenses after the FCC's cellular radio lotteries randomly transformed ordinary citizens into instant millionaires. However, Congress deadlocked over auctions for HDTV frequencies. Some members liked the idea of raising (and spending) the estimated $3.5 billion to $70 billion that could be raised by auction. Other members supported the broadcasters' case for free use of the frequencies "in the public interest." The reason that HDTV is more highly "affected with the public interest" than PCS is not readily apparent; the theory of this paper suggests that some members of Congress simply depend on broadcasters for electoral support and favorable coverage back home to a greater extent than other members do. Unable to break the deadlock, Congress dropped the issue from the Telecommunications Act of 1996.

18. These provisions are contained in the Communications Decency Act of 1996, which is part of the overall Telecommunications Act of 1996.

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Decision-Making Interests in Perspective

The overarching course of telecommunications policy just outlined is consistent in direction with policy choices that *could* have emerged from a deliberate application of economic principles. Clearly, however, that course was not produced by the conscious application of principles. Rather, it was an artifact of the conflicting interests of regulators, legislators, and judges. These conflicts, played out in a climate of competition, brought about the creative destruction of status quo regulation.

State Regulators

State regulators increased their utility by discovering clever ways to shift local exchange costs into the interstate jurisdiction. Doing so created settlement revenues that regulators applied against the cost of residential exchange service, thereby causing its price to be about one-half of that charged for comparable business service. This policy choice might seem surprising: the Economic theory of regulation predicts that business subscribers would organize to capture a substantial share of the interstate revenues. Instead, regulators distributed the gains among residential subscribers, and businesses rarely appeared in state rate proceedings to press their interests as ratepayers. The key to understanding this paradox lies in the high visibility of telephone rates. Residential subscribers—that is, voters—know how much they pay for telephone service compared to the amount paid by businesses; it is common, for example, for rates to be published in the front pages of telephone directories. This knowledge makes it awkward for regulators to favor business subscribers. Moreover, favoring residential subscribers satisfies the populist notion that business should pay benefits to individuals. The utility-maximizing choice for regulators, whether elected or appointed to office, is to favor residential subscribers. Similar reasoning applies to the subsidization of exchange service through state toll revenues. Here too the redistribution flowed from business subscribers, who are relatively heavy users of toll services, to residential subscribers.

In contrast, the tendency of state regulators to benefit high-cost rural subscribers agrees with the Economic theory of regulation: rural subscribers are a relatively concentrated interest group, and the cost of benefiting them is easily and invisibly spread over the general body of ratepayers by means of cost and rate averaging. Policies that favored contemporary subscribers over future subscribers through the prescription of exceptionally long depreciation periods is a no-brainer given that future subscribers have no current political voice.

State regulators furthered their own interests by policies that prevented competitors and end-users from dissipating regulatory rents. Accordingly,

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state legislators and regulators promoted a monopoly industry structure and resisted competition and deregulation until the conflicting interests of the FCC, Department of Justice, federal courts, and Congress first eroded, then terminated the states' ability to capture rents through status quo regulatory policies.

Federal Regulators

The FCC took little interest in telephone regulation until 1965, when Congress, responding to concerns voiced by constituents, directed it to investigate interstate rates. Previously, the FCC's business consisted largely of awarding broadcast licenses and passing upon license renewals, activities ostensibly driven by "public interest" considerations but in fact intensely political.[19] Changes in political sensibilities, coinciding with the exhaustion of assignable broadcast licenses, changed the dynamics of the FCC, which by the mid-1960s was using its power over broadcasting and telephony to promote the normative social goals of the Great Society.

Congressional pressure to investigate interstate rates revealed the FCC's inability to regulate the telephone industry, because of the industry's control over essential information and because of its political power—that is, its ability to satisfy the private interests of regulators and legislators at all levels of government. The FCC's backdoor approach to regulation—the use of limited competition—was adopted only as a regulatory tool.

FCC decision makers captured regulatory rents by bending policies to favor political interests and by pursuing remunerative private-sector jobs. Many FCC commissioners moved into law partnerships and management positions in the telecommunications industry. Commissioner Kenneth Cox, who supported the grant of operating authority to MCI, became a senior vice president of MCI immediately upon the expiration of his FCC term. Commissioner Benjamin Hooks, who encouraged the use of monopoly rents to train and employ minorities, became executive director of the NAACP. (Not all commissioners were so fortunate: the career and subsequent life of Commissioner Thomas Mack were ruined by his FCC activities; and Mack's legal assistant chose suicide over an investigation of his own activities.)

FCC staffers face a shorter list of capturable rents than do commissioners. The principal rents capturable by staff are ideological—making the world work according to such private preferences as the attainment of abstract efficiency goals, for example. The pursuit of efficiency goals by FCC staff surely played a role in the agency's policy choices from *Carterphone* onward, and resonated with the appointment of pro-market commissioners

19. See generally the sources cited in note 1.

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and senior staff during the Reagan Administration. Even so, the agency's articulation of a regulation-free telecommunications industry structure did not occur for several more years (Fowler, Halprin, and Schlichting 1986), by which time substantive policymaking authority had shifted to the *MFJ* court.

Federal Courts

The private interests of judges had a substantial impact on telecommunications policy. The court's *Hush-a-Phone* decision created new property rights for telephone users (rights to use) by taking rights away from AT&T (rights to exclude) and industry regulators (rights to decide). The *MFJ* court controlled national telecommunications policy between 1984 and 1996, adopting policies often at odds with those recommended by the FCC, the National Telecommunications and Information Agency (NTIA), and the Justice Department. The judges fashioned policies according to their own notions of how the world ought to work, frequently without regard for economic principles, market realities, and the evidentiary record.

Congress

Congress's failure to enact telecommunications legislation until 1996, posturing for twenty years during a period of profound change, is consistent with the rent-seeking and rent-extraction model advanced in this essay. Enacting legislation quickly in response to changing circumstances, as opposed to promising or threatening action over a protracted period, does not necessarily maximize the private value inherent in Congress's right to decide the issues. Decisive action removes (or at least changes) the incentives for private factions to deliver further electoral support (campaign contributions, votes, and so forth) and other rents. So long as at least one strong faction actively opposes legislation, the present value of decision-making rents can be increased by delaying action. The resulting pattern of timing and activity is consistent with the predictions of the Status Quo theory of regulation identified earlier, although its actual roots are very different.

By 1996, market realities made it irrational for any strong industry faction to hold out against legislative change, because of the new profit opportunities and because new technology had rendered status quo regulation unsustainable. The Baby Bells, for example, foresaw wireless technology eroding the demand for traditional wireline communications. Congress saw this as well: Senator Robert Packwood (1995), who prior to his premature departure from Congress was chairman of the Senate Communications Subcommittee, expected the Bells to lobby Congress by the year 2000 seeking a multibillion dollar tax write-off for wireline plant rendered obsolete by wire-

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less technology. This prospect suggests not only the likelihood of substantial legislative rents being captured down the road, but also that status quo regulation and rent extraction policies had reached a logical end.

The Act's passage was assured when all industry factions came to see regulatory change as in their private interest. Legislators dutifully voted these interests, perhaps telling themselves that their votes were justified by the predicted growth in jobs, GNP, and tax revenues.

Summary

The Communications Act of 1996 set the stage for a new cycle of rent seeking and rent extraction by government and industry factions. Four target areas have been identified: control over telecommunications content; new bureaucracies with broad and autonomous power to redistribute wealth; statutory price discounts for designated consumers; and prospective tax legislation. Other areas surely exist and will be revealed over time.

It is reasonable to predict that some of the factions that supported the Act will clamor for renewed regulation in the near term. Apart from a few obvious technological "synergies," such as the capacity for telephone, television, and multimedia services to be delivered over a single wideband cable or optical fiber, it is far from certain that unfettered competition will produce substantial profits for any player, much less for all of them. As the realities of telecommunications technology and markets become manifest, some players will discover that they are holding the short end of the deregulatory stick. Given the billions of dollars at stake, this discovery will lead to reregulation initiatives designed to protect carriers against "unfair" competition, both foreign and domestic. Successful players also have an incentive to seek regulatory protection of profitable market niches, and will invoke the proven mantra of telecommunications "universality" in the attempt to get it. Politicians and bureaucrats will discover new opportunities to build political capital and extract rents by promising and threatening reregulation, just as Congress profited in the past by regulating cable television rates, only to deregulate them, then reregulate them, then deregulate them again.

The Telecommunications Act of 1996 does not signal the end of government intervention in telecommunications markets. Rather, it signals a new beginning, with new rules, new players, and new opportunities to capture decision-making rents. These opportunities, along with ongoing changes in technology, will drive the next cycle of telecommunications policy.

This essay benefited from comments by three anonymous referees. The usual disclaimers apply.

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BOOK REVIEWS

✦ **Economic Thought before Adam Smith: An Austrian Perspective on the History of Economic Thought. Vol. 1**

By Murray N. Rothbard

Brookfield, Vt.: Edward Elgar Publishing Company, 1995. Pp. xvi, 556. $99.95 cloth.

Classical Economics: An Austrian Perspective on the History of Economic Thought. Vol. 2

By Murray N. Rothbard

Brookfield, Vt.: Edward Elgar Publishing Company, 1995. Pp. xvi, 528. $99.95 cloth.

Those who have been teaching the history of economic thought for enough years to be satisfied with their syllabus should approach Murray Rothbard's two-volume history of economic thought with extreme caution. It might compel a costly syllabus revision. That was certainly a large part of the author's intention.

In Rothbard's account, Adam Smith tumbles from his pedestal as the founder of economics and becomes someone who ignored many of the achievements of his predecessors and set the discipline on a misguided course from which it took a century or more to recover. David Ricardo came after Smith and went even farther in the wrong direction that Smith had taken. After Ricardo's death, the community of economists quickly discerned Ricardo's errors and repudiated most of his theoretical contributions. But the immense authority and prestige of John Stuart Mill, who in his early teens had imbibed Ricardo's ideas in large doses from his father, restored

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Ricardo and the so-called classical tradition to its wholly undeserved and pernicious position of influence.

The basic classical error was the insistence on cost-of-production explanations of relative prices and the slighting or dismissal of explanations based on utility and scarcity. Rothbard attributes this error to two factors. One was the Calvinistic reverence for work and distaste for consumption of the Scotch Presbyterian culture that directly influenced Adam Smith and infected Ricardo and later John Stuart Mill through James Mill. The elder Mill had been trained in Scotland to be a Presbyterian preacher, and he did not abandon his puritanical and crusading mindset when he become an atheist. The other factor accounting for the classical tradition's emphasis on production costs and neglect of subjective valuations in explaining relative prices was its obsession with the long run.

The error of Smith, Ricardo, and the Mills is inexcusable, Rothbard maintains, because the correct approach lay ready at hand for all of them in many of the writings of the Scholastics and in a vigorous French tradition running through Cantillon, Turgot, Condillac, Say, and Bastiat. William Stanley Jevons' exasperated comment comes to mind, in his preface to the second edition (1879) of *The Theory of Political Economy:* "The truth is with the French School, and the sooner we recognize the fact, the better it will be for all the world." But Jevons asserted no more than an earnest desire to overthrow the assumptions and doctrines of the Ricardo-Mill economics. Rothbard lays irreverent hands on the sacred figure of Adam Smith himself.

In the course of making his case, Rothbard provides exceptionally full and informative presentations of the work done by Cantillon, Turgot, Say, and Bastiat, and offers persuasive evidence that James Mill had far more influence on Ricardo's economics than has been generally recognized. In another departure from the pattern of the standard texts, he devotes more than 100 pages to the important controversies over money and the banking system that took place in Britain between roughly 1790 and 1850. He also provides a surprisingly full account of Marxism, from which it emerges after almost 150 pages as a tissue of fallacies with enormous destructive potential. In concluding his hostile appraisal of John Stuart Mill, "a woolly minded man of mush" (vol. 2, p. 277), Rothbard accurately characterizes his own approach to the discussion of ideas. After Mill, Rothbard writes, British economics falls into the hands of "academics and their constituencies [who] all too often confuse contradictory wavering with complexity, wisdom, and judiciousness of mind" (vol. 2, p. 294). There is no contradictory wavering in these two volumes.

Both volumes fully live up to their overall title: *An Austrian Perspective on the History of Economic Thought.* Rothbard scrutinizes almost every thinker he discusses for evidence of pre-Austrian insights or un-Austrian

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error. In Pythagoras of Samos, who wrote in the sixth century B.C., Rothbard finds "the embryo of the burgeoning and overweeningly arrogant mathematical economics and econometrics of the present day" (vol. 1, p. 9). Plato is faulted for employing the "murky concept" of the happiness of the *polis,* in defiance of the fact that "the city-state or community consists only of living, choosing *individuals*" (vol. 1, p. 11). Aristotle, on the other hand, is credited with "at least a hint of the later fully formed Austrian marginal utility theory of value" (vol. 1, p. 17), and with partially anticipating "the crucial Austrian point—made with particular force and elaboration by the twentieth-century Austrian economist Ludwig von Mises—that economic theory is but a part, a subset, of a broader, 'praxeological' analysis of human action" (vol. 1, p. 18). Such comments will certainly irritate non-Austrian readers of the book and can eventually tire even the sympathetic reader. But no one finishes a chapter wondering where the author stands.

Rothbard's Austrianism is of the staunch type forged by von Mises. In this tradition, the true and correct approach to understanding economic phenomena is through theory, and definitely not through the accumulation of data of doubtful meaning and significance. The theory must be based on fundamental premises about individual human nature that are necessarily true (apodictically certain), and it should be expressed in ordinary language, not in mathematics, which leads the economist to distort reality by losing sight of human action. Employment of these premises yields the insight that all value is the product of subjective, individual evaluations that interact with resource availabilities to generate relative prices. Productive resources derive their value and hence their prices from the evaluations and prices of consumer goods, not the other way around as the British classical tradition stubbornly asserted for so long. This brand of Austrianism favors laissez-faire policies because its theory demonstrates the effectiveness of voluntary exchange in promoting human welfare and is hostile to the state, which is a coercive institution.

This perspective prompts Rothbard to give special attention in the first volume to thinkers who wanted to limit the authority of the state, to natural law theorists, and to theological speculation. He laments the decline of scholastic thought and Thomism, with its emphasis on reason and natural law, and the ascendancy of the Protestant emphasis on the essentially arbitrary nature of the divine will and of ethics.

The general title of the two volumes is accurate in another way: this is a history of economic thought, not a history of the science or discipline of economics. That becomes abundantly and even tiresomely clear in the first volume, as Rothbard takes us through endless references to obscure medieval writers who somewhere or other recorded their thoughts on prices, money, or interest (usury). Knowledge does not accumulate in their hands,

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as it does for the practitioners of any functioning science. Rothbard generally thinks highly of "the late Spanish Scholastics," but their pronouncements on the important and vexing issue of usury, as he presents them, trace a back-and-forth, up-and-down course that fails to consolidate the insights gained along the way. Like the other medieval writers, they do not seem to have taken any real interest in economic analysis, a fact that ought not to surprise us, and consequently do not develop a science of economics.

Richard Cantillon's brilliant insights raise a different but related problem. Cantillon took a keen interest in understanding the operation of what we have come to call economic systems and what he called "commerce in general." But he exerted so little influence on the development of the discipline that he had to be rediscovered by Jevons 150 years after his death.

What should be said about Rothbard's handling of the thinker he refers to sarcastically as "the celebrated Adam Smith"? Rothbard is not here pouring scorn on someone in the opposite camp. Smith is still today much revered by many who would be Rothbard's allies in the realms both of economic theory and economic policy. Moreover, Rothbard assembles the evidence against Smith with great care, making judicious use of scholars such as Edwin Cannan, Joseph Schumpeter, Alexander Gray, T. W. Hutchison, and Salim Rashid, the last of whom has published a number of recent studies aimed at deflating Smith's reputation.

If we evaluate Smith by his contributions in *The Wealth of Nations* to the formal theory of relative prices, both of final goods and so-called factors of production, a strong case can be made that Smith was a disaster for the discipline of economics. That is the criterion Rothbard mainly employs. But was this Smith's principal contribution to the evolution of the science that came to be known as political economy in the nineteenth century and as economics in the twentieth? Or was it his recognition that extension of the division of labor had given rise to a new kind of society, which he called "a commercial society," in which everyone became a kind of merchant and lived by exchanging?

Perhaps Smith, even as a price theorist, was not so abject a failure as Rothbard claims. A correct explanation of how prices, costs, and incomes are related to one another requires the simultaneous appropriation of three insights: (1) that all prices result from subjective evaluations (the utility insight); (2) that the relevant valuations are marginal valuations (the marginal insight); and (3) that everything depends on everything else (the general equilibrium insight). Grasping all three and holding them together was a task beyond Smith's understanding and, I would argue contrary to Rothbard, beyond the understanding of any other writer prior to the end of the nineteenth century. Many thinkers before and after Smith recognized the

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importance of utility and scarcity in any adequate explanation of relative prices. However, there is a great difference between recognizing their importance and weaving them into a coherent and comprehensive theory of relative prices.

Rothbard's two-volume history of economic thought will inspire much fruitful discussion of such questions. (*The Review of Austrian Economics* is already contemplating a symposium on Rothbard's critique of Smith.) We must deeply regret that Rothbard's untimely death prevented him from completing the promised third volume of his history. Works that combine so much scholarship, clarity, freshness, and courage have become rare in economics.

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✦ The War Against Authority: From the Crisis of Legitimacy to a New Social Contract

By Nicholas N. Kittrie

Baltimore and London: Johns Hopkins University Press, 1995. Pp. xx, 304. $29.95 cloth.

"It is the business of the government to manage matters relating to the government; it is the business of subjects to mind their own properties and interests." Thus charmingly did Justice Allybon define ruler-subject relations in 1688. If only it were that simple! And it might be, except for the ambiguous nature of government: its power is necessary for public order but causes just fear in the people. Force and fear act on each other and threaten escalating distrust and violence between the rulers and the ruled unless something intervenes to build trust.

The perennial contest between "authority" and "autonomy" and the pursuit of political legitimacy are the subjects of Nicholas N. Kittrie's *The War Against Authority* (the quotation above appears on p. 171). The heart of Kittrie's book is a history of challenges to political authority in America and a succinct outline of the same theme in an international context, with emphasis on France, Germany, Britain/Ireland, and Russia. Kittrie prefaces this study with a search for the causes of dissent both in the background and psychology of the political offender ("frustrated expectations," "status incongruity") and in the behavior of governments (overreaction, arrogance). The perspective is part criminological with a touch of social psychology, part legal and constitutional, the whole set against history and within a modest framework of political theory. Kittrie focuses on the means and

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principles invoked and used by, and against, rebels, dissidents, terrorists, and minorities.

Kittrie deals with this contentious subject fairly, without demonizing or glorifying either rebels or authority. His well-organized and soberly spoken work will interest students of politics, law, history, current affairs, and conflict research, both in academia and outside.

The United States of America, born of a rebellion against colonial rule, itself immediately faced the question of how to treat those who had sided with the English or remained neutral. The chief legal means available was the English law of treason. The erstwhile traitors were now the government, and the previous loyal subjects were now traitors. Because the revolutionists had held English prisoners, the English had treated their American captives as prisoners of war, not as traitors, thus sparing them the horrid punishment of "drawing and quartering" (described on p. 85). This decision, a result of necessity, humanized the political strife and set a precedent for the American government in its postwar treatment of rebels. In Shays' Rebellion of 1787 and the Whiskey Rebellion of the 1790s, men were sentenced to death, but all were pardoned. Kittrie carefully outlines subsequent challenges to American authority, describes in well-referenced detail the legislative means and principles adopted by the government, and points out overreactions.

The English catchall concept of treason goes back to Edward III's First Treason Act of 1352. Treason implied a breach of the subject's personal loyalty to the ruler. Little by little its content was changed by judicial construction to cover any breach of public order.

On the European continent, political crimes were divided into lèse-majesté, referring to breaches of domestic order, and treason, the betrayal of the country to an enemy power. Both originated in late Roman law. Punishments for these crimes were, without exception, extreme. In France political crimes were exempt from the procedural safeguards that applied in ordinary criminal cases. In the eighteenth century, philosophers such as Montesquieu, Voltaire, and Beccaria and enlightened rulers brought about some reform, but the shock of the French Revolution provoked a conservative reaction.

The nineteenth century saw a marked liberalization in the treatment of political offenders. In Britain the main cause was the influence of liberal philosophers such as Jeremy Bentham, accompanied by highly successful social and economic policies that created progress and removed much discontent. In France, Kittrie suggests, the cause was connected with the quick succession of rulers and regimes and the realization of the current rulers that tomorrow they themselves might be toppled from power. In both countries, "transportation" was a favored punishment.

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The democracies have stuck to leniency, notwithstanding vacillation during the interwar period. Some commentators have even suggested that these regimes have been too lenient with their internal enemies, but Kittrie rejects the contention of Barton Ingraham that bourgeois regimes harbor a "death wish" (pp. 201–2).

In the totalitarian countries of the twentieth century, entire classes of citizens were categorized as politically suspect. Where the government owned everything and controlled all institutions, as in the Soviet Union, every offense was political (p. 207). In the Russian Federation, as late as 1985, failure to return from a foreign country constituted treason, for which the punishment was death (pp. 207–8).

The authoritarian regimes of Latin America and elsewhere combine some of the worst features of Stalinist Marxism with features of perverted capitalism. Their policies are "zealous, intolerant, and frequently inconsistent" (p. 217). Commitment to single-salvation doctrines such as Marxism or religious fundamentalism exacerbates oppression. But the inconsistency of such governments sometimes permits uncharacteristic tolerance of political opponents (p. 220).

The treatment of political rebels as belligerents rather than as criminals, as during the American Revolution, has often proved necessary where resistance to government is widespread or enjoys the support of public opinion. Again, the effect has been humanizing. Recent examples include Afghanistan, Ethiopia, and Israel (p. 220).

In the last chapter, Kittrie considers authority in an increasingly pluralistic world and the need for a new legitimacy. Unfortunately, he does some beating about the bush here. Having presented much well-sifted historical data, the author is overcautious regarding what to make of the evidence. He notes that "a growing number of political philosophers have been arguing that the overall legitimacy of the state's authority has been declining" (p. 226). But his witnesses, limited to the contributors to one volume of essays, do not specify the period of decline, its causes, or its exact nature. Kittrie himself, like many social scientists, laments the sketchiness of relevant statistics (pp. 231–37); yet he speaks of "the current global unraveling of authority" as an established fact (p. 228). He offers little opinion of his own but points to a general weakening of the "authority" of American institutions such as the church, the family, and the workplace (p. 228) and to a serious loss of business and corporate stability (p. 241). But how are "greedy buyouts" and "unmarried teenage pregnancies" related, and how do they affect political legitimacy? Something is going on, but what is it?

Despite occasional blandness in certain summing-up passages, the author is considerably firmer in his grasp of the international situation and the nature and causes of national and ethnic unrest (pp. 241–51).

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Some of the book's shortcomings arise from an inadequate theoretical framework. Kittrie bravely tackles a large theme and does a fine, focused job with the historical data. But the nature of the crisis of legitimacy—I agree there is one—could have been delineated more convincingly with better theoretical tools. Kittrie's main guides to the fundamental concepts of authority and legitimacy are Gaetano Mosca, with his Machiavellian concept of legitimacy as a "political formula," and Max Weber, with his three categories of legitimate *Herrschaft.* A work that shows better than any other the fundamental social function of legitimacy, and with less cynicism than Mosca, is Guglielmo Ferrero's historical-political study *Principles of Power* (New York: Putnam, 1942)—a somewhat neglected classic.

Kittrie might have asked whether certain social or economic policies of the postwar welfare states have provoked disaffection by raising unrealistic and perhaps improper expectations in the citizenry. Answering that question, however, would require boldness and a more powerful theory.

In a brief and excellent epilogue, Kittrie displays a sure instinct by approving Thomas Jefferson's plea for democracy based on the local community: "divide the county into wards" (p. 254). (The misattributed quotation is from Jefferson's letter to Joseph C. Cabell, 2 February 1816—a source well worth studying.) Kittrie praises the idea, expressed by "the ghastly Euro-word" *subsidiarity,* that a political task should be carried out at the lowest functional government level (p. 256). But he leaves related questions unexplored. For instance, granted the principle, who decides the correct level? (Look at what happened to states' rights in America, despite the Constitution's tenth amendment.) Competently applied, subsidiarity would surely help to promote ethnic peace, as demonstrated by the Roman and Ottoman Empires, which governed successfully for centuries by respecting the ethnic diversity of their huge realms.

One promising avenue to improved legitimacy that was not considered by Kittrie is the more frequent use of initiatives and referendums. (A useful source is *Referendums Around the World: The Growing Use of Direct Democracy,* ed. David Butler and Austin Ranney. Washington: AEI Press, 1994.) Direct democracy by ballot is a peaceful and orderly alternative to extralegal protest. Its directness also bars political backroom deals that may stir public animosity. The social peace of Switzerland despite the country's religious and linguistic divisions attests to direct democracy's effectiveness.

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✦ Strong Managers, Weak Owners: The Political Roots of American Corporate Finance

By Mark J. Roe

Princeton: Princeton University Press, 1994.
Pp. xiv, 324. $19.95 paper, $39.50 cloth.

Diffuse stock ownership is the rule for large American corporations. It is rare to find a single shareholder with even 10 percent of the stock of a Fortune 500 company. As a result, shareholders have little incentive or ability to affect corporate policies if they disagree with management: managers are strong and owners are weak. Economists have long been concerned about the possible maladies of this condition, most notably that the corporation might be run to advance the interests and ambitions of its executives rather than to generate value for its stockholders.

Fragmented ownership is commonly thought to be the inevitable consequence of corporate evolution. Scale economies make it efficient for firms to grow large. Their capital needs eventually expand beyond the resources of individual investors, either because no single investor has enough resources to fund the operation or because individual investors desire diversification and do not want to put all their eggs in one basket. Thus, modern economies appear to face an unsavory tradeoff between efficient firm scale and efficient shareholder control.

Mark Roe's impressive book, *Strong Managers, Weak Owners,* suggests that such a tradeoff may be illusory. Turning received wisdom on its head, he argues that diffuse ownership is not an inevitable consequence of corporate evolution. Rather, in the United States it is the result of a series of *political choices* over the last century. His argument runs on two tracks. First, he pinpoints the precise laws and regulations that have impeded the formation of large stockholding blocks and, second, he discusses corporate governance in Germany and Japan, where the laws are different and large blockholding is common.

The conventional explanation of fragmented ownership is at least partially correct—few individuals could come up with the $386 million necessary to buy 1 percent of General Motors (as of February 1996)—but it is incomplete: financial institutions such as banks, insurance companies, mutual funds, and pension funds have the resources (combined assets of $11.8 trillion in 1993) to buy large blocks. Why don't they?

Roe's answer is that the United States has created a virtually impenetrable wall of legal obstacles. The core of the book is a careful discussion of these obstructions, including the following: commercial bank sizes were limited by antibranching laws and deposit insurance, and banks were virtually prohibited from equity ownership by the National Bank Act, Glass-

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Steagall, and the Bank Holding Company Act of 1956; equity ownership by insurance companies was severely limited by New York regulations; mutual funds were pushed to hold fragmented portfolios by tax laws, and short-swing trading rules made passive investment advantageous; ERISA made management control of pension funds desirable, and managers are unlikely to use large blocks to exert pressure on their fellow managers; and corporations are inhibited from cross-holdings by dividend taxes.

The book leaves no doubt that a variety of legal hurdles stand in the way of large blockholding. But they are not insurmountable. Bank holding companies can put 5 percent of their assets into stock (Wells Fargo holds over 1 percent of GM); New York life insurance companies can place 20 percent of their assets in equity, and casualty insurance companies such as Berkshire Hathaway can put even more; mutual funds can invest up to 3 percent in a portfolio firm and still be legally fragmented; public pensions are fairly unrestricted; and so on. How do we know that the hurdles really explain diffuse ownership? The most compelling evidence Roe provides is the observation that blockholding is the rule in Germany and Japan. Banks were not split by Glass-Steagall in Germany, and often take big positions in large firms. The *keiretsu* system in Japan involves banks and vertically related companies in cross-holding relationships. These observations alone make the case that fragmentation is not inevitable. They do not prove, however, that U.S. fragmentation is caused by the legal environment. Indeed, the book notes that diffuse ownership is also common in Great Britain, where financial institutions do not face American-style legal impediments. It may be that diffuse ownership arises from deeper economic factors having to do with the economic function of corporations, financial intermediaries, and so on. It will take more research to determine for sure.

Roe's ideas about political economy are even more intriguing. If we accept the notion that American fragmentation was caused by American laws, the natural question is, Why were such laws adopted in the United States and not in Germany or Japan? What is the political economy of fragmentation? Roe offers three possibilities. First, the configuration of interest groups may have been different in the United States. For example, there may have been more small banks that benefited from laws limiting the size of big banks. But he concludes, plausibly I think, that it is hard to identify enough groups with an interest in fragmentation to make this story convincing. (Roe suggests that corporate managers benefit from fragmentation, but this is not clear to me. There is little evidence that managers were involved in creating the fragmentation laws. I suspect that every American manager who extols the virtues of fragmentation could be matched by one from Germany or Japan who sees the advantages of large blockholdings.)

Roe's second political hypothesis is that the geographic nature of

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political representation in the United States produces a bias toward fragmentation. For example, if 434 congressional districts each have one small bank, and the 435th district (New York City) has three huge banks, the vote will be 434 to 1 in favor of laws that restrict the power of large banks. In contrast, Germany elects its parliament by party, not by region, and Japan has a system that is only loosely regional. Whether this hypothesis holds water theoretically and empirically requires more work, but it has enough surface plausibility to merit additional investigation.

Roe's third hypothesis is that the United States has a dominant political ideology opposed to concentration of economic power. The rhetoric of politicians, regulators, and journalists provides plenty of evidence. Neither Germany nor Japan (nor, I suspect, any other industrialized country) has laws fragmenting financial institutions and preventing horizontal expansion by corporations like those in the United States. But the introduction of ideology to explain the difference in fragmentation has the feel of a deus ex machina; where does this ideology come from? Why is it present in the United States and not elsewhere? How might we measure it? At this point, it is no worse an explanation than arguing that the differences in ownership across countries arise from some unspecified "technological" factors, but neither view has enough empirical support to be persuasive.

In a book self-described as "suggestive" and intended to point out new avenues for research, it might seem strange that the last five chapters are devoted to policy recommendations. How can we make policy in such a state of ignorance? Nevertheless, Roe's suggestions are eminently sensible. His basic argument is that because we know less than we thought about the causes of fragmentation, and observation of other countries indicates that the costs of concentration are not too high, good policy would be to allow institutions more flexibility in ownership structures. Roe suggests we should relax existing laws and allow competition among governance forms. This relaxation would allow corporations to adopt the ownership structure that suits them best, and would generate more information about the benefits and costs of different structures. The other general policy prescription concerns securities law. In the current legal environment, it is possible for individual institutions to accumulate significant minority blocks of a firm's stock, but not enough to exercise control without the help of other stockholders. However, communication between such stockholders could easily run afoul of securities law. Roe suggests, again quite reasonably, that these rules be relaxed to allow blockholders to coordinate their actions.

The ultimate value of a book such as this is measured less in the questions it closes than in the ones it opens. Roe has shown convincingly that much of what we thought we understood about corporate governance was wrong. Fundamental questions need to be revisited, and the political roots

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of fragmentation examined. By laying out a road map for this important endeavor, Roe's book promises to serve as an influential stepping-off point for thinking about the modern corporation for years to come.

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✦ Public Goods and Private Communities: The Market Provision of Social Services

By Fred Foldvary

Brookfield, Vt.: Edward Elgar, 1994. Pp. xi, 264. $69.95 cloth.

This work demonstrates strong logic, thorough research, and use of the scientific method. Unfortunately, the argument is too disjointed to persuade those to whom it should be directed—neoclassical economists who accept the market-failure argument for public good provision.

Foldvary divides his book into three parts. In the first eight chapters he constructs a theoretical argument for voluntary community provision of public goods. The next five chapters present case studies of providing public goods consensually in communities. The final two deal with urban economics, public choice, and methods for increasing consensual governance.

Foldvary starts his theoretical argument by examining and rejecting the market-failure argument for public good provision: "The theme of this book is that this proposition is incorrect. The market-failure argument treats persons as atomistic agents living in ether rather than in three-dimensional space and in a context of institutions and history" (p. 1). He makes this argument so successfully that I found the first chapter the most valuable in the book. A standard public finance parable illustrates the argument: People living in a valley would benefit from constructing a dam. The market-failure argument implies that voluntary contributions would not suffice to pay for the construction, and the public choice argument holds that politically powerful interests can affect the dam construction decision, leading to a larger dam. Foldvary offers a third example to counter these two gloomy prospects—the communities living in the valley create community associations, and the associations finance the dam if the increased land value resulting from the dam's construction exceeds the cost of the dam. Strict constitutional limits on the powers of the associations would diminish the potential for political failure.

The first chapter also surveys the literature on public good provision, rejecting the necessity of public good provision in the cases of education, lighthouses, and even national defense. Foldvary then summarizes the

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standard Samuelsonian model of public good provision and proposes a taxonomy of public goods, using unconventional terms (*congestible* and *capacious* instead of *rival* and *nonrival*).

Foldvary continues to criticize the market-failure argument in the second chapter, where his focus is the logic of the argument and the criteria by which the market outcome is judged. In rejecting the Pareto optimality criterion, he observes that "the market fails only relative to an unrealizable ideal system, not relative to governmental provision" (p. 21). The focus then narrows to concentrate on territorial collective goods, a class that Foldvary contends in reality comprises most public good provision. Relying on the premise that the values of territorial amenities are capitalized into land values, he argues that territorial goods are functionally excludable and therefore can be funded through user fees or means other than taxation. Site rent internalizes spatial externalities, inducing resources to flow to their most valued use. In making the argument, he fails to elaborate on how it differs from or improves on the standard Tiebout argument for polycentric government; nor does he discuss how the governance institutions relying on territorial site rents for revenue would differ from local governments that collect property taxes. He establishes the theoretical potential for using capitalized land rents to fund territorial goods, but he does not deal with the institutional issues: organizationally, how would a community association differ from a local government? Nor does he discuss the contention that having a local government to collect user fees based on marginal increases in rent could be the least-cost institutional structure, and this omission makes his argument less persuasive.

In the fourth chapter, Foldvary looks for insights in the literature of industrial organization, particularly the work of Coase and Cheung, but the effort is awkward and ultimately unsatisfying. He views a civic association as a firm with a contractual relationship between the association and the members/residents, but a firm is premised on well-defined and well-enforced property rights. Foldvary does not discuss here how realistic the analogy is for the provision of territorial goods, and he does not consider how a communal governance structure realistically would differ from a local government. He could have integrated the material from the previous chapter to argue that the marginal land rent would reflect ownership share, but he does not take that step.

In chapter 5, the author considers the distinction between consensual and imposed governance, an important distinction that, if integrated into the rest of the argument, could answer my previous questions about how a communal governance structure would differ from local government as we understand it today. Foldvary envisions the provision of territorial goods through constitutionally constrained associations that contract with their

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members; but his failure, throughout the book, to contrast this type of provision explicitly and repeatedly with local government provision weakens the argument.

In chapter 6, invoking a Buchanan-style club model, Foldvary argues that including space in a club model shows the effect of increased amenities on land rent, and that induced rent gives property owners an incentive to invest in territorial goods providing such amenities. His model is sound, but I question his placement of it outside his earlier discussion of territorial goods in chapter 3. I was also concerned about the conspicuous omission of the standard "Henry George theorem" in the club literature. David A. Starrett (*Foundations of Public Economics.* Cambridge: Cambridge University Press, 1988, p. 84) presents a club model incorporating space, resulting in "optimality" of public good provision when the local government owns all of the land and can tax all land rent. Starrett's analysis is similar to Foldvary's, but is within the institutional confines of neoclassical economics from which Foldvary is trying to escape. Only by dealing with work such as Starrett's would Foldvary influence the thinking of mainstream economists on the institutional structure in which site rent can be used to fund public goods.

In chapter 7, Foldvary argues that even nonterritorial collective goods can be provided voluntarily, based on "Smithian sympathy," or our fellow feeling with others. In this chapter he does not explicitly consider the standard economic rebuttal of that argument, which is that the good would be provided suboptimally. Earlier, in chapter 2, Foldvary argues persuasively that Pareto optimality is a false, unrealistic criterion, but he does not reinforce the point here, thereby making his argument for Smithian sympathy ring hollow for those who do not agree with him initially.

The next section contains case studies of consensual governance and territorial good provision. Foldvary seeks to demonstrate that voluntary provision of territorial goods is feasible, not that it will necessarily occur. He contends that falsification of the market-failure hypothesis requires only actual examples, not a formal theoretical rejection. After an introductory chapter highlighting some of the issues arising in the case studies, we visit the following consensual communities (one chapter for each institution): Walt Disney World; Arden, Delaware; the Fort Ellsworth Condominium, Alexandria, Virginia; Reston Association, Reston, Virginia; and the private places of St. Louis. Each chapter starts with a hypothesis to falsify, usually in the form of "the community association will fail to provide civic goods and amenities." Recall that Foldvary has rejected Pareto optimality as a criterion of the "correct" level of collective goods provision, so he has left himself with straightforwardly falsifiable hypotheses, especially given his thorough research and discussion of the details pertaining to each case. Unfortunately, he does not consistently provide systematic discussion of the hypotheses

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(particularly in the Arden chapter), nor does he reinforce what he has shown in each case and tie it to the theoretical discussion in the first section of the book. Thus, the entire work seems disjointed, with little explicit connection between the theoretical and the empirical parts.

Two final chapters highlight possibilities for consensual governance in urban areas and propose means of increasing consensual governance. Foldvary proposes constitutional reform to promote polycentric government, and reiterates that goods with economies of scale could still feasibly be provided by associations of associations.

My general criticism is that the book as a whole might have been better organized and articulated. As mentioned earlier, the treatment of territorial goods is separated between chapters 3 and 6, but integrating this discussion in a single coherent chapter and bringing in more criticism of orthodox, opposing views would make the argument more persuasive. Another articulation problem is the lack of transitions, both among ideas in a given chapter and between chapters; the choppiness in the flow of the argument distracts the reader from its substance. Most important, Foldvary's argument as it is presented probably will persuade only those, like me, who already agree with him and who have sufficient background in public choice and in state and local public finance to fill in the missing transitions and overlook the distraction of extraneous details.

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✦ State and Party in America's New Deal

By Kenneth Finegold and Theda Skocpol

Madison: University of Wisconsin Press, 1995.
Pp. xiv, 342. $19.95 paper, $54.00 cloth.

On my graduate school field exam in economic history, I was asked whether the New Deal was a watershed for the twentieth-century American economy. I suspect my professors were looking for an answer having to do with macroeconomic policies and the growth of government. Instead, I answered that the New Deal had been a watershed because its dramatic expansion of the national government created for the first time a group of trained and professional government employees who could (and did) contemplate and manage a greatly expanded role for the government in the economy. In this book, Kenneth Finegold and Theda Skocpol take a similar tack. They interpret the success or failure of major New Deal programs as hinging on the government's administrative or "state" capacity to implement the programs.

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One of the major puzzles of New Deal history is why, after 1935, the government abandoned the policy approach embodied in the National Recovery Administration (NRA) while persisting in reform and recovery efforts in other areas, including agricultural price supports and production controls, unemployment relief, social welfare, and public works, even in the face of considerable political and judicial opposition. Finegold and Skocpol frame a solution by comparing the failure of the NRA and the success of the Agricultural Adjustment Administration (AAA). A group of well-trained, competent, experienced professionals was available to implement the agricultural policies, whereas no comparable group was available to implement the NRA's policies. In addition, Finegold and Skocpol explain some details of New Deal agricultural and industrial policies by relating them to the internal structure of the Democratic Party. Hence the "state and party" of the book's title.

The argument about state capacity is compelling. Government support of agriculture certainly is the best example of how academic experts (in this case, agricultural economists), private-sector beneficiaries, and government administrators can form an effective coalition to achieve their own objectives at the expense of the general public. The only other equally successful coalition of this sort that comes to mind is the military-industrial complex, which has an altogether different composition and rationale.

Potential readers should be alerted, however, that the NRA and the AAA are only minor players in the book. The main subject is political theory. Finegold and Skocpol seek to show that their theory of state capacity and party alignments is superior to all other major (and many minor) theories, from rational choice to Marxism, that attempt to explain government behavior. Their mastery of the huge pertinent literature is impressive and the density of their references overwhelming. Roughly half the book is dedicated to developing their theory and comparing their approach to those of pluralists, elite theorists, Marxists, and rational choice theorists. If you delight in such comparisons, this is the book for you.

The extended attention to theories, however, comes at considerable cost: the authors pay too little attention to the New Deal programs themselves. The AAA is conveniently categorized as a production control program, even though Finegold and Skocpol are aware that supporting prices by means of demand enhancement was an alternative option pursued for certain commodities throughout the New Deal period. Given that most farmers favored higher prices but opposed production controls, Finegold and Skocpol's theory gets a high mark for explaining something that alternative theories cannot easily explain, namely, that the AAA did implement a number of production controls. Nonetheless, the authors' characterization of New Deal agricultural policy as primarily production control is a mistake—oddly, one they seem to be aware of even as they make it.

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Finegold and Skocpol explain the origin of the National Industrial Recovery Act (NIRA) as simply the New Deal's hurried reaction to Senator Hugo Black's proposed legislation to limit the work week. Poorly crafted and administratively underpowered, the NIRA was doomed to fail. From its ashes, of course, rose the Wagner Act, the National Labor Relations Board, and a reinvigorated labor movement that became an integral part of the Democratic coalition. That a program begun to advance the interests of capitalists turned into one to advance the interests of organized labor is another paradox that Finegold and Skocpol's theory can explain better than alternative theories.

Economists call the sort of big-picture events the authors seek to explain "stylized facts." Although stylized facts sometimes serve a useful purpose, more often they are pernicious in their effect on analysis. No doubt Finegold and Skocpol would agree that the kind of historical institutionalism they promote ought to be grounded in nothing less than a detailed examination of the historical record with all its peculiarities and inconsistencies. Most likely, their preoccupation with political theories and the extensive effort they devote to that part of their study account for their flattened portrayal of the New Deal programs.

JOHN JOSEPH WALLIS
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✦ Selling War: The British Propaganda Campaign Against American "Neutrality" in World War II

By Nicholas John Cull

New York: Oxford University Press, 1995.
Pp. xv, 276. $29.95 cloth.

It is hard to believe that "propaganda" was originally a neutral term, in some circumstances even a positive one. Derived from the Latin *propagare*, it meant simply a systematic publicizing of a given doctrine or worldview. For years the prominent Roman Catholic theologian and publicist Bishop Fulton J. Sheen was national director of the Society for the Propagation of the Faith.

Only in the 1930s, with the rise of what was called the "totos" (totalitarian regimes), did the entire concept come to appear somewhat shady. Propaganda was what the other side disseminated, a dangerously one-sided presentation deliberately designed to manipulate a gullible public. Its role was to prevent the dispassionate analysis required for responsible citizenship, indeed for the very survival of one's nation. Yet the term itself was

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not yet entirely discredited, being used unabashedly by the British government as late as 1941.

Hence the new study by Nicholas John Cull, lecturer at Britain's University of Birmingham, is particularly welcome. It is a fine work, steeped in previously untapped British sources and showing a firm grasp of recent American research. Much of the source material is uncovered here for the first time. Cull writes that the British government "seems to have tried to destroy the evidence of its war propaganda in the United States" (p. 4).

It is hardly surprising that from September 1939, when Britain declared war on Germany, until December 1941, when the United States became a full-scale belligerent, John Bull made every effort to entice Uncle Sam into the conflict as an equal fighting partner. By the summer of 1940, Hitler had conquered almost all of western Europe and appeared about to invade Britain itself. By the spring of 1941, Britain had suffered the loss of Greece and Crete and was being pounded in North Africa. By the late fall Hitler's army stood before the gates of Moscow.

In February 1941 Churchill downplayed his desire for full-scale American intervention, saying, "Give us the tools and we will finish the job." Cull writes, "Of course, Churchill wanted more than 'tools'" (p. 127), and once the United States had entered the conflict, Churchill confessed that the event was something he had "dreamed of, aimed at, and worked for." The words *worked for* are the tip-off. Only with the publication of Cull's study can we finally appreciate just how the British propaganda machine helped bring America to the brink of war, leaving it to the Japanese and Hitler to make Churchill's dream a reality.

At the outset of the European war in 1939, the British had distinct advantages in seeking American aid: a common political and cultural tradition and several decades of informal political alliances. But there were also sources of tension: the British record in Ireland, India, and Palestine was widely seen as oppressive; Britain still owed war debts to the United States; and Britain's recent diplomacy in Ethiopia, Spain, and Czechoslovakia was less than distinguished. Further, some extreme anti-interventionists saw British propaganda in World War I as having enticed the United States into a destructive conflict.

British propaganda was subtle, and wisely so. For Britain to have done less than it did, writes Cull, would have been disastrous, for its citizens needed all the help they could muster. Yet had the propaganda been more heavy-handed or peaked earlier, it would have provided additional ammunition to already suspicious anti-interventionists. The battle to win American sympathies was not entirely uphill, for Americans had long detested Nazism and, from the outset of the war, were horrified by accounts of Nazi occupation, particularly in Poland. The bombing of British cities also shocked

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Americans, making the word *Blitz* a household term. To use the phrase of a media bureaucrat, the aim of British propaganda was to sharpen the "incipient inclinations" of its audience, that is, to "make friends friendlier."

In the British propaganda effort, Cull shows, American foreign correspondents played a crucial role, as the British wisely cultivated a working relationship with the American press. The British manipulated specific instances of bomb damage, for example, by releasing in the United States photos deemed too gruesome to be shown at home. CBS's Edward R. Murrow was so effective in conveying what the British were undergoing that Churchill offered him the post of codirector general of the BBC.

Knowing how important movies were to the American public, the British quickly established a beachhead in Hollywood. Alfred Hitchcock (*Foreign Correspondent,* 1940) and Alexander Korda (*That Hamilton Woman,* 1941) joined the American movie colony, serving as able emissaries. Also stationed in America were classicist Gilbert Highet and philosophers A. J. Ayer and Isaiah Berlin. Inside the British Isles a host of authors wrote propaganda with more than one eye toward the United States—political scientist Harold J. Laski, novelists Graham Greene and C. S. Forester (whose name Cull curiously misspells), and publicist Norman Angell, a converted pacifist.

Even World War II buffs will be surprised by some of Cull's findings. Consider, for example, that President Franklin D. Roosevelt, meeting with King George VI at Hyde Park several months before the war broke out, assured the king that any bombing of London was bound to bring the United States into the war. When Paris fell to the Germans, FDR estimated Britain's chances of survival as one in three. Far from "appeasing" the British, Roosevelt drove a hard bargain in the destroyers-for-bases deal (and, though Cull does not say so, in lend-lease as well). Within Roosevelt's supposedly "Anglophile" administration, Assistant Secretary of State Adolf Berle harbored extensive suspicions of the British, as did FBI director J. Edgar Hoover.

The British propaganda apparatus, though seeming quite effective to an outsider, was riddled with bitter interdepartmental rivalries. Many of its early efforts were highly ineffective, and its early failures were "legendary." Director of Information Hugh Macmillan was an utter disaster in his post. Churchill, though himself a master of words, saw only limited value in propaganda, whereas British ambassador Lord Lothian, despite having been sympathetic to Germany through Munich, was a surprisingly effective emissary. Lothian's successor, Lord Halifax, British prime minister at the time of the Czech crisis, was initially an absolute dud in dealing with Americans. (Never leave your hot dog on a bench when leaving a baseball game, and never compare the game to cricket, much less add "except that we don't question the Umpire's decision so much in England" [p. 134].)

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Cull confirms the popular picture of British security coordinator Sir William Stephenson without accepting as gospel the portrait in Stephenson's self-serving memoir *A Man Called Intrepid: The Secret War* (New York: Harcourt Brace Jovanovich, 1976). Berle was not exaggerating when he claimed Stephenson was operating a "full size secret police" (p. 145) in the United States. Indeed, interventionist organizations such as the Fight for Freedom Committee were closely linked to this British apparatus.

A few of Cull's statements are incorrect or misleading. Many of Roosevelt's victories, including cash-and-carry, conscription in 1940, and lend-lease, received congressional approval by more than "the narrowest of margins" (p. 201). Roosevelt's "Good Man" telegram to Prime Minister Neville Chamberlain was sent before the Munich Conference, not in its wake. And Porter Sargent's anti-British bulletin was started before the war broke out.

All in all, however, Cull has contributed an extremely valuable book, crucial to understanding how the world's greatest power entered the most destructive war of all time.

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✦ The End of the Republican Era

By Theodore J. Lowi

Norman: University of Oklahoma Press, 1995.
Pp. xix, 275. $22.95 cloth.

In the fall of 1994, the Republican Party won a majority in both houses of Congress for the first time since the Eisenhower landslide of 1952. Many observers believed that the Republicans had finally achieved the partisan realignment and Republican majority prophesied by Kevin Phillips in the late 1960s. Under the leadership of Newt Gingrich and Rush Limbaugh, the Republicans united three disparate groups: entrepreneurial Republicans, who celebrate the free enterprise system and seek to reduce or eliminate taxes and government regulations; evangelical Republicans, who are shocked by the social decay they perceive around them and hunger for the return of a moral community premised on Christian certitude; and Eurocentric Republicans, who fear cultural relativism in their schools, racial minorities and illegal aliens in their midst, and loss of jobs in the new world economy. Overwhelmingly white and decidedly male in its composition, this alliance has set the tone of contemporary political debate in the United States. It is the nature of this coalition (and its internal contradictions) that Theodore Lowi examines in *The End of the Republican Era*. In doing so, Lowi traces the

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birth and possible death of both the current Republican majority and republican government in the United States.

Lowi's new book is primarily a work of ideological exegesis. Citing Keynes's famous observation that "practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist" (pp. 100, 245), Lowi describes the ideological traditions that have dominated American politics and discourse. Striving for intellectual clarity and a rescue of political terminology from the prison of journalistic clichés, Lowi begins his analysis by defining "liberalism" and "conservatism" as these terms traditionally have been used by political philosophers, historians, and European intellectuals. He then traces the evolution of classical liberalism in the United States into the New Liberalism that became the dominant public philosophy during the New Deal. When this New Liberalism begat massive government expansion in the 1960s and 1970s, a conservative backlash ensued that, in turn, led to the Republican era of Lowi's title. This is a complex story, and Lowi believes that its telling requires, first of all, a close examination of the liberal principles on which American constitutional government was originally premised.

According to Lowi, liberalism—as classically viewed from the writings of John Locke, Adam Smith, and Thomas Jefferson—identifies individual freedom as the highest political value. Democratic governments are constituted by autonomous individuals, who act collectively to create political institutions that function to protect individual rights of life, liberty, and property. Government, therefore, is not sovereign; the people are. Government may intrude in the workings of society only to protect the rights of its citizens.

Reprising the arguments of his seminal work *The End of Liberalism* (2d ed. New York: Norton, 1979), Lowi examines how this traditional understanding of liberalism became Old Liberalism while a New Liberalism emerged from one of the central premises of classical liberalism. Lowi sees the seed of New Liberalism in Old Liberalism's tenet that government authority is legitimate only when individual rights require protection. As John Stuart Mill argued in his essay, "On Liberty," "Over himself, over his own body and mind, the individual is sovereign." Thus, "the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others" (*The Six Great Humanistic Essays of John Stuart Mill,* ed. Albert William Levi. New York: Washington Square Press, 1963, p. 135).

Lowi makes the important—and in our judgment accurate—observation that this apparently minimalist view of government actually becomes an open-ended grant of governmental authority once the goal of preventing harm is pushed to its logical extreme. The Great Depression of the 1930s

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and the constitutional revolution engineered by the Roosevelt administration destroyed the judicial barriers to the expansion of federal power into virtually every aspect of the nation's economy. This revolution was brought about through judicial acceptance of federal laws that not only expanded federal power but delegated immense authority to judges and bureaucrats. Lowi sees this development as an understandable response to the crisis of the 1930s, but he views its subsequent continuation as unnecessary and undesirable. This New Liberalism, with its totalitarian concern for the prevention of injury wherever it might occur, led to the development of the massive but irresponsible and ineffective federal government (dominated by well-organized interests) that Lowi described so memorably in *The End of Liberalism.*

In *The End of the Republican Era,* Lowi goes beyond the analysis of his earlier work by demonstrating how the crisis of liberalism in the 1960s and 1970s led to the emergence of conservatism as a national political force. He explains this process through a skillful analysis of contemporary American conservatism and its roots in the American historical experience. Lowi sees American conservatism as something of an anti-ideology that eschews rationalism and systemic inquiry and instead celebrates the authority of tradition, community, and religious absolutes.

Brilliantly refuting the influential thesis articulated by Louis Hartz in his *Liberal Tradition in America* (New York: Harcourt, Brace & World, 1955), Lowi argues that liberalism is not the only American ideological tradition, but has always coexisted with an invisible (to academicians) but equally influential conservative tradition. Lowi attributes the invisibility of conservatism to the federal political structure of the United States, which enabled pursuit of traditional liberal ideals at the federal level while allowing implementation of conservative agendas at the state and local levels. Liberalism was institutionalized nationally with the ratification of the Bill of Rights in 1791, but these rights were not systematically extended to the states until activist judges began to do so in the 1960s. Thus, federalism allowed for a national government that preserved the rights and freedoms necessary for the development of a capitalistic economy and the prevention of a national police state, while reserving police and regulatory powers to the states, which could enforce restrictions on personal freedom in the name of community norms and religious truth. Because of its provincialism and its influence primarily among the uneducated, conservatism was viewed by the academy as an anomaly, a movement irrelevant to the real and central liberal tradition of America.

However, conservatism became a national movement when New Liberalism's expansion of government encroached on the local police powers exercised by conservatives. The commitment to the prevention of injury, so

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cherished by New Liberals, led to the nationalization of the protection of individual rights. In accordance with the tenets of New Liberalism, activist courts and government agencies enforced these rights to minimize harm to racial minorities, women, atheists, homosexuals, and even flora and fauna, enraging conservatives in the process. As New Liberals encroached on their parochial powers, conservatives nationalized their movement by uniting with Old Liberals against their common enemy, the activist federal government.

Lowi is correct in giving Ronald Reagan immense credit for the construction of this alliance between Old Liberals and conservatives that elected Reagan twice and gave Republicans control of Congress in January 1995. By focusing his followers' attention on the evils of the existing national government while exercising his unique gift for the delivery of oxymoronic platitudes, Reagan forged a coalition of freedom-loving Old Liberals and freedom-loathing conservatives that has survived his presidency.

Lowi sees this coalition as fundamentally flawed, because it attempts to reconcile traditions that are in direct opposition to one another. He sees the unification of Old Liberals (who support unrestrained capitalism, secular government, and individual rights) with conservatives (who distrust capitalism, support Christian government, and put community order above individual liberty) as contradictory. And he sees this contradiction as the beginning of the end of the Republican majority in the United States, an insight that gives *The End of the Republican Era* its title. However, Lowi's title is a pun because he also argues that contemporary conservatism is a threat to American republicanism, as its tenets are in opposition to the principles of majority rule and individual rights enshrined in the constitution.

In our judgment, Lowi is correct in his conclusion that populist conservatism is a threat to liberal rights because it acknowledges only the authority of God, scripture, tradition, and community norms. However, in identifying this contradiction and demonstrating how fragile the Republican coalition is, Lowi undermines his own assertion, which he never plausibly explicates, that the Christian Right is a genuine threat to American democracy. Lowi tells us first that extreme conservatives have gained national power by uniting with Old Liberals, then that the alliance between the two groups is bound to disintegrate. He fails to identify how conservatives will subvert the democratic process when they are stripped of the power of the Republican coalition. Nevertheless, even if his title is hyperbolic in its implied alarm over the fate of the republic, Lowi is entirely correct in demonstrating that the Republican coalition is an ideological muddle unlikely to yield effective and coherent public policy.

Lowi's concluding chapter is appropriately titled "Restoring the Liberal Republic." Echoing *The End of Liberalism,* Lowi argues that the path out of the ideological confusion and republican disintegration promoted by both

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New Liberalism and contemporary conservatism is a return to rule by law, that is, the clear drafting by Congress of statutes that avoid vague language, ambiguous goals, and the delegation of power to judges and bureaucrats. If Congress embraces the principle of rule by law, it can regain its accountability to the electorate and respect for the boundaries essential to constitutional government.

Lowi's recommendations are sensible and desirable, but they fail to provide a comprehensive strategy for dealing with the contemporary American crisis. By focusing on ideologies and the philosophical traditions from which they developed, Lowi presents a brilliant, useful, and often original analysis that makes a significant contribution to a better understanding of a political debate often lacking minimal intellectual coherence. However, *The End of the Republican Era* lacks the systematic analysis of the realities of historical change, social structure, and economic interests that made *The End of Liberalism* an instant classic. Perhaps it is unfair to critique an important book for not being a great one, but Lowi's text does not meet the promise of its title or the publisher's jacket description of the work as a true "sequel to his most renowned book, *The End of Liberalism.*"

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✦ The Economic Anatomy of a Drug War: Criminal Justice in the Commons

By David W. Rasmussen and Bruce L. Benson

Lanham, Md.: Rowman & Littlefield, 1994.
Pp. xiii, 265. $59.50 cloth, 23.95 paper.

Prohibition is a poorly understood public policy. Most people, including drug addicts themselves and those who treat addiction, do not understand addiction. Many people do not really care to understand the murky workings of the black market and drug dealing. For most of those who study, discuss, and write about public policy, the subject of illegal drugs is far away and unimportant.

Economists and classical liberals have shown some interest in prohibitionism, but for the most part they have produced only polemics and peripheral research. For example, I would speculate that economists have written more about the economics of sports than about the war on drugs.

Prohibition and drugs are certainly messy matters. The black market economy is a dangerous and criminal environment. Corruption of police,

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public officials, and the democratic process only increases the unsavory nature of the issue. In terms of one's academic career, championing the entrepreneur in the abstract is more acceptable than championing drug dealers and moonshiners; the cause of the unspecified consumer is more attractive than that of the drug addict; and advocating programs for the poor receives a much warmer reception than advocating the legalization of drugs, with all its real and imagined horrors.

Research on illegal drugs is hard work, too. The type of data that modern quick-and-dirty research employs simply is not available. Existing data on black markets and crime are inherently suspect and difficult to interpret. No one has much incentive to pursue research in this area. The two main incentives for academics (consulting dollars and research grants) are virtually nonexistent. Although the government provides a great deal of funding, it is one-sided—directed at burnishing the images of the drug warriors and their war.

Economists and classical liberals generally do not realize that the prohibitionists are on the march, winning the policy debate and gaining ground every day. Most economists support drug legalization and take comfort that professional leaders such as Milton Friedman and Gary Becker have articles on the subject in prominent magazines and newspapers. Classical liberals have convinced themselves of their own arguments and take solace in the trend toward legalized gambling and public discussions of drug legalization.

In reality, the war on drugs has been escalated enormously and has become a public policy model for dealing with a lengthening list of social problems: crime, delinquency, illiteracy, pollution, child abuse, disease, and nasty habits. Ominously, the war on drugs is being fought with the aid of an ever-expanding number of violations of the rule of law: civil forfeiture of assets; use of the military in domestic law enforcement; illegal search and seizure; illicit evidence and perjured testimony; and failure to provide fair and speedy jury trials.

High-ranking public officials have become crusaders for prohibition. Vice President George Bush, the first drug czar, led the war on drugs in the 1980s, cheered on by First Lady Nancy Reagan. Later, during his presidency, Bush declared that wine has the same nature as cocaine. We now have a government program to drastically reduce alcohol consumption by the year 2000. Bush appointee David Kessler, head of the Food and Drug Administration, is leading a prohibitionist crusade called "Smoke-free America 2000," clearly trying to prohibit the use of tobacco in the same manner that earlier crusaders prohibited the use of narcotics and marijuana.

It is important to remember that legalized gambling and all the public and academic debate about legalizing drugs rest on the model of "modified" prohibition, not free markets. Clearly, the prohibitionists are now firmly

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ensconced in the government bureaucracy; and they are winning the ideological and policy battles.

All of this makes the publication of *The Economic Anatomy of a Drug War* extremely important. Never before has drug prohibition been dissected in such accurate and enlightening detail. David Rasmussen and Bruce Benson concentrate their analysis on the period from 1984 to 1989, when drug arrest rates skyrocketed and the government supposedly achieved its greatest victories in the war on drugs. The two economists bring a variety of analytical tools to bear on the subject and report on an extensive research program they conducted or supervised. Their writing makes the material widely accessible. The lessons and surprises are abundant.

They analyze first the official rationale of prohibition: that drug use causes crime. Libertarians and left-liberals, responding to the official line, often assert that criminalization causes high drug prices, which lead the addicts to commit property crimes to finance their expensive habits. Rasmussen and Benson report that both views are wrong. Most users of illegal drugs are not addicts, are employed, do not commit property crimes, and indeed are more likely to have crimes committed against them. Criminals gravitate toward the profits of dealing in drugs more often than drug use itself causes crime.

The authors also show that law enforcement does not necessarily result in deterrence, that the response to higher levels of enforcement is not limited to reducing illegal activity, and, further, that the actual responses make the war less, not more, effective. Although some casual users may be deterred or encouraged to switch to legal drugs, the evidence shows that heightened enforcement has led to the consumption of more potent and more dangerous drugs. Higher drug arrest rates that caused prison overcrowding and early releases of prisoners (as well as much more plea bargaining) also reduced prison time and therefore the expected cost of punishment. In addition, suppliers resorted to juvenile street dealers, who face less severe sentences, so the net effect of stepped-up enforcement in the 1980s was to increase the pool of drug dealers, especially among children.

Rasmussen and Benson show that the escalation of enforcement increases property crime, violent crime, and corruption and does not reduce drug abuse (it may increase it!). Their logic is impeccable. As the police focus on drugs, protection of property is diluted. Police sweeps of drug markets disperse dealers into surrounding areas, causing new rounds of turf battles and violent crime, while greater enforcement results in higher prices, higher profits, and greater opportunities for bribery of police. For example, Illinois maintained its property crime rate while escalating the war on drugs, but traffic control and safety suffered, and the state's highway death rate rose 1,200 percent faster than the national rate.

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Rasmussen and Benson's most penetrating analysis pertains to why we got the drug war in the first place. The Comprehensive Crime Act of 1984 allowed local police to get money (and therefore higher budgets) from confiscated property involved in drug *investigations*. The introduction of crack cocaine was a result, not the cause, of the augmented drug war. Public opinion did not generate it. Only 2 percent of people polled said that drugs were the most important problem in 1985, but 38 percent called it their most important concern in 1989, just as the drug war was being moved to the political back burner. Simply put, the police and judicial bureaucracies benefit from the drug war while dispensing justificatory propaganda and performing inefficiently at the public's expense.

One hopes this book will provoke much additional research. What may be most important and provocative is Rasmussen and Benson's argument that the criminal justice system itself (the classic public good) manifests a tragedy of the commons and that the problems of drug enforcement are only symptoms of a generally flawed system. In this light, analysis of prohibition may be viewed as a case study exposing the kind of problems inherent in an irrational, publicly provided criminal justice system.

When criminal justice is provided by the state and is accessible to everyone, it is overused by the public and politicians. Worse, it is misused, inefficient, and unaccountable. In the limit, its value to society evaporates, and society does without criminal justice—an outcome fraught with peril for everyone. Thus, the drug war exemplifies a greater, looming problem that must be resolved if we are to have a free and stable society.

Although Rasmussen and Benson have made a significant contribution to our understanding of prohibition and the war on drugs, the truly radical nature of their book resides in its characterization of the workings of a publicly provided criminal justice system. Readers interested in this more fundamental matter should also consult Bruce Benson's previous book, *The Enterprise of Law: Justice without the State* (San Francisco: Pacific Research Institute for Public Policy, 1990) as well as the forthcoming books from the Independent Institute, *Private Criminal Justice* and *The Evolution of Law*, where he argues that justice, law, and the maintenance of order can be contractual, privately produced, and efficiently supplied, and shows that such systems are not only theoretically conceivable but have existed and operated successfully.

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Etceteras . . .

ONE OF THE WEARIEST CLICHÉS in political discourse is Pogo's observation that "we have met the enemy, and he is us." Again and again, mercilessly, commentators and pundits deliver the melancholy conclusion that it is pointless to complain about the government because, in a democracy, "we are the government." Among the most recent authors to fall back on this exhausted bromide is Hillary Rodham Clinton, who observes in *It Takes a Village* (New York: Simon and Schuster, 1996, p. 312) that "government is not something outside us"—it "is us."

Now, if this observation were correct, most of us would be certifiable lunatics by virtue of what "we" are doing to "ourselves." Of course, any adult with an IQ above 70 understands that, in the great multitude of instances, "we" are not coextensive with the government. Most of us are not masochists.

Breaking loose from the high-school-civics conception of government ought to be the first step of one's education in political science. Even the dictionary can help. The *Random House Dictionary* defines government as "the political direction and control exercised over the actions of the members, citizens, or inhabitants of communities, societies, and states," or simply "political administration." This definition is helpful as far as it goes; at least it hints that where there is government, someone exercises direction and control *over* someone else. Still, a dictionary definition cannot reveal the blood-and-steel reality of the "administration" involved in governing.

The most vivid and truthful description I have come across—one guaranteed to cure anyone suffering from acceptance of the Pogo fallacy—was penned by the French socialist Pierre-Joseph Proudhon in the mid-nineteenth century. Proudhon took the literal approach:

> To be GOVERNED is to be kept in sight, inspected, spied upon, directed, law-driven, numbered, enrolled, indoctrinated, preached at, controlled, estimated, valued, censured, commanded, by creatures who have neither the right, nor the wisdom, nor the virtue to do so. To be GOVERNED is to be at every operation, at every transaction, noted, registered, enrolled, taxed, stamped, measured, numbered, assessed, licensed, authorized, admonished, forbidden, reformed, corrected, punished. It is, under pretext of public utility, and in the name of the general interest, to be placed under contribution, trained, ransomed, exploited, monopolized,

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> extorted, squeezed, mystified, robbed; then, at the slightest resistance, the first word of complaint, to be repressed, fined, despised, harassed, tracked, abused, clubbed, disarmed, choked, imprisoned, judged, condemned, shot, deported, sacrificed, sold, betrayed; and, to crown all, mocked, ridiculed, outraged, dishonored. That is government; that is its justice; that is its morality.

And all that *before* the tremendous growth of government during the past 150 years!

For calling this passage to my attention, I am grateful to Deirdre McCloskey. The source is P.-J. Proudhon, *General Idea of the Revolution in the Nineteenth Century,* trans. John Beverley Robinson (London: Freedom Press, 1923), p. 294. I will personally pay $20 to anyone who sends me a better description of government.

ROBERT HIGGS

Correction

The editor regrets that two changes requested by Irving Louis Horowitz were not made in his paper, "Culture, Politics, and McCarthyism," in volume I, number 1. On p. 104, "Charles Westoff" should have been "Norman Ryder." On p. 106, the sentence referring to Leo Strauss's observation should have read as follows: "We should recognize the importance of Leo Strauss's observations in *Persecution and the Art of Writing* about the relationship of culture and oppression: that it may serve as a stimulant to creativity."

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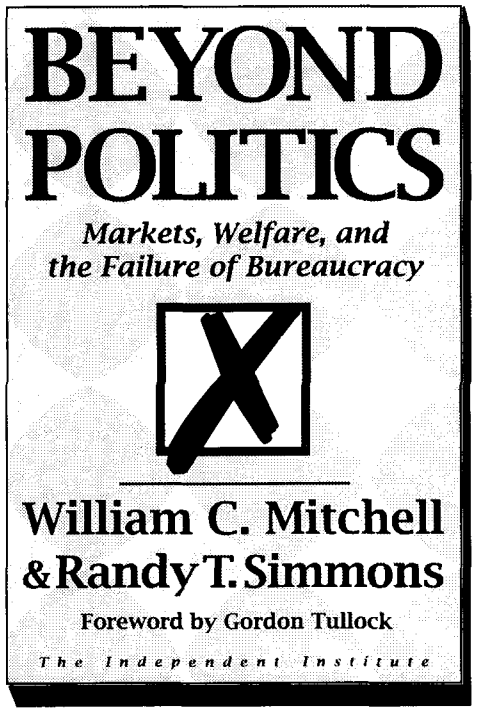

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